

REPORT

# JOBS FOR THE FUTURE

THE PATH BACK  
TO FULL EMPLOYMENT  
IN THE UK

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Tony Dolphin,  
Kayte Lawton and  
Clare McNeil

## ABOUT THE AUTHORS

**Tony Dolphin** is Senior Economist and Associate Director for Economic Policy at IPPR.

**Kayte Lawton** is a senior research fellow at IPPR.

**Clare McNeil** is a research fellow at IPPR.

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This report is part of IPPR's work on promoting growth and shared prosperity in the UK. This programme of work aims to identify public policies that will promote the economic growth needed to return the UK to full employment and ensure the benefits of future prosperity are more equally shared. For more, see <http://www.ippr.org/research-projects/44/7144/promoting-growth-and-shared-prosperity-in-the-uk>

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IPPR  
4th Floor  
14 Buckingham Street  
London WC2N 6DF  
T: +44 (0)20 7470 6100  
E: [info@ippr.org](mailto:info@ippr.org)  
[www.ippr.org](http://www.ippr.org)  
Registered charity no. 800065

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SMART IDEAS  
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# EXECUTIVE SUMMARY

## Broad employment trends

Employment levels in the UK fell less than forecasters expected during the recent recession and have recovered faster than most predicted since the recession ended. Even so, the employment rate is now just 70.7 per cent, compared to a peak of 73 per cent that was sustained for much of the period from 2000 to 2007. Mainstream forecasters, including the Office for Budget Responsibility, believe it will still be below 73 per cent in 2015. In the short-term, one of the government's main priorities should be to promote a return of the employment rate to its pre-recession level.

This should only be a first step. A higher employment rate – perhaps as high as 80 per cent – would in the long-term ease some of the problems faced by successive governments in the UK. It would mean higher taxes and lower welfare payments, simultaneously making balancing the budget easier and ensuring sufficient funds are available for universal services such as health and education. And it would make it easier for the economy to cope with the ageing of the population.

The path back to full employment will not, however, be an easy one. The evidence suggests that the public sector has been filling in for insufficient private sector job creation over the last 20 years. One certainty in the next few years is that public sector employment will fall, so if private sector employment does not increase rapidly, the economic recovery is likely to be weak or not 'jobs rich'. Given this headwind, it is doubtful that policies so far put in place by the government will be sufficient to promote a return to full employment within four years.

If this is the case, there is a risk that hysteresis effects<sup>1</sup> will lead to some men – and, for the first time in the UK, significant numbers of women – permanently leaving the labour market as their skills become redundant or they are discouraged from seeking work. These effects could be magnified by regional disparities in employment growth because the North East, Yorkshire and the Humber, the West Midlands and Scotland will lag behind unless there is a marked turnaround in the willingness and ability of the private sector to create jobs in these regions.

## Composition of the workforce

The last decade saw substantial shifts in the composition of the UK workforce, as a result primarily of three factors:

1. technological change
2. globalisation
3. an expansion of employment in the public sector.

Driven by the first two factors, the composition of the workforce will continue to change. The vast majority of new jobs created in the UK over the next decade will come in the private service sector. Manufacturing is now too small a proportion of the economy to make much difference to aggregate employment levels, even if there is a substantial rebalancing of the economy in its favour. What few areas of manufacturing strength remain in the UK tend not to be labour intensive. A more useful distinction than the one between manufacturing and services is that between tradable and non-tradable goods and services. As part of the effort to generate sustainable and balanced growth, policies

---

<sup>1</sup> Hysteresis occurs when a short-term drop in employment rates persists in the medium to long term. This may be due, for example, to workers becoming disillusioned and quitting the labour market, or losing the skills needed to find work.

should support, in particular, employment in tradable goods and services industries. Key industries where the UK has a competitive advantage, such as professional, business and scientific services and the information, communication and creative industries (and possibly financial services too) will be vital for job creation in the future.

The make-up of the UK workforce has been shifting gradually in favour of more skilled jobs for over two decades. Most new jobs created in the UK over the next decade will be skilled jobs. New technology, combined with globalisation, creates jobs for skilled workers, but destroys jobs for semi-skilled and some low-skilled workers. It is not clear where new semi-skilled jobs might come from but further losses of low-skilled jobs in traditional areas such as manufacturing and clerical roles are likely to be offset by gains in areas such as social care and consumer service industries.

### Disadvantaged groups

The recession had no disproportionate effect on the employment outcomes of most traditionally disadvantaged groups, including ethnic minority groups, older people, women and the disabled. But history suggests groups that are at risk of being left behind as employment increases include the long-term unemployed, older workers who have lost jobs in declining industries or occupations, young people who have entered the labour market since the recession began and who have not established a stable work pattern, and people with few skills.

There are significant long-term challenges to raising the employment rate among older people, some ethnic minority groups and people with a disability. Projections suggest employment among these groups will increase less rapidly in coming years than in the years prior to the recession. The weak and worsening labour market position of adults with no or only low-level formal qualifications has been further damaged by the recession, adding a cyclical problem on top of an existing structural one. The employment prospects of this group should be of particular concern.

### Policies in place to promote full employment

Many of the macroeconomic policies being implemented by the Coalition government to support private sector employment growth – such as cuts in corporate tax rates, deregulation and the introduction of enterprise zones – were tried in the 1980s. There is little evidence to suggest they worked then and the risk is that they will prove largely ineffectual in current circumstances. At the same time, the government has abolished regional development agencies and replaced them with a Regional Growth Fund and local enterprise partnerships (LEPs). However, the budget of the Growth Fund is modest – £1.4 billion over three years – and LEPs have very limited powers. It is not clear how much difference these initiatives can make to employment prospects outside London and the South East.

The government is also introducing the Work Programme to tackle long-term unemployment and the universal credit to simplify the benefits system and increase incentives to work. There will be significant challenges in implementing these policies as a result of the fiscal constraints under which the government has forced itself to operate.

Although the ambitions behind the universal credit are the right ones, many of the original intentions have been watered down because of the fiscal climate. The reforms risk substantial administrative upheaval for little gain on work incentives.

The new funding regime for the Work Programme, which offers providers incentives if they sustain individuals in work, could improve the matching of individuals to jobs, which is critical to overall labour market performance. However, the Department of Work and Pensions (DWP) has set demanding performance requirements for providers at a time when long-term unemployment is rising. The financial pressures on Work Programme providers could result in reduced standards of service, fewer personal advisers and higher caseloads.

The Work Programme could play a far greater role in preparing long-term unemployed young people for apprenticeships and in so doing improve the relatively low level of

employer uptake for apprenticeships in the UK. The longer length of time individuals will spend on the Work Programme opens up opportunities for sustained pre-apprenticeship training, however many providers are unclear as to how to integrate apprenticeships within their provision. There are also concerns about the variable quality of apprenticeships, particularly in those sectors with little tradition of providing apprenticeships.

The Coalition is sticking with an employer-led approach to skills. This has its merits in that it should ensure that qualifications developed and supplied are in demand. But it creates the risk of under-investment in training and education and could lead to future skill shortages, to the detriment of employment levels. There is a bigger role for government to help ensure that future skills needs are anticipated.

## Recommendations

It appears the Coalition government's plans for growth and job creation will be insufficient to meet the combined challenges of high unemployment and growing labour supply over the next few years. As a result the employment rate is unlikely to be back to its pre-recession level by 2015. New policies – or changes to existing policies – are needed to promote a quick return to full employment in the UK. These should focus on promoting growth and limiting the expansion of long-term unemployment. They should encompass macroeconomic policy, job subsidies and a modern industrial strategy to help support strong private sector growth. Policies are also needed to avoid the hysteresis effects associated with recession by getting the recently unemployed back into work quickly and supporting job creation for the long-term unemployed. There should also be more support for childcare so that the employment rate can eventually be lifted towards 80 per cent.

Our recommendations focus on promoting growth in employment and limiting the expansion of long-term unemployment:

1. The government should announce a £5 billion increase in capital spending to improve the country's infrastructure and boost employment in the beleaguered construction sector. The Monetary Policy Committee should increase quantitative easing by £50 billion now, with the option of a further £50 billion in three months' time if the economic outlook has not improved.
2. The government should abandon its plans to cut corporate tax rates further, saving around £2 billion by 2014/15 that could be used for other measures to promote employment in the UK.
3. Rather than rely on corporate tax cuts and deregulation, the government should produce a new plan for growth – a modern, active industrial policy for the next decade based on the latest economic thinking and best practices from overseas, designed to promote growth in the private sector and rebalance the economy.
4. The government should expand the Green Investment Bank into a fully-fledged public investment bank, with a lending strategy focused on SMEs, innovative firms, high-growth firms and infrastructure, as well as low-carbon sectors. Its initial capitalisation should be increased to £15 billion and it should be able to raise funds on capital markets immediately, rather than having to wait until 2015.
5. The government should introduce a UK-wide scheme, along the lines of the Welsh ReACT scheme, to encourage people who are made redundant to retrain for work in other sectors and to encourage employers to recruit and train them. This scheme should last throughout the period of large-scale job cuts in the public sector, when redundancies in the whole economy are likely to be abnormally high, but should be available to workers formerly employed in the public and private sectors.
6. The government should make the provision of better local labour market information a priority. Initially, the focus should be on Jobcentre Plus, which, as part of its role, should provide job seekers with information about current and likely future trends in employment demand in their locality and surrounding areas. Eventually, this information should be made more widely available through government websites.
7. To strengthen routes into apprenticeships for long-term unemployed young people aged over 18 and to improve uptake among employers, clearer guidance should be

given to Work Programme providers on the role they can play and any barriers to their participation should be removed.

8. The government should offer a guaranteed job, paid at the minimum wage or above, to anyone who has been unemployed and claiming JSA for more than 12 consecutive months. The guarantee should be matched by an obligation to take up the offer or to find an alternative that does not involve claiming JSA. The job should be for no more than 30 hours a week to allow a reasonable amount of time each week for job search and should last a maximum of six months. Jobs could be provided by the third sector or local government.
9. The government should reconsider its decisions to reduce the amount of childcare support that can be claimed through the tax credit system and to integrate the childcare element of the tax credit into the universal credit. It should plan to introduce a single, integrated funding system for childcare that merges tax credit provision and the tax relief provided for childcare vouchers. This system should support all parents, but offer the greatest amount of support for those on low incomes.

# 1. INTRODUCTION

Full employment has been a goal of all UK governments in the post-war period, supporting as it does some key policy objectives. In the current context, the broad tax base that full employment helps to deliver is vital to ease the squeeze on government finances and guarantee the long-term affordability of essential universal services like health and education. Looking out over the next few decades, full employment will become even more important as the population ages, requiring a workforce capable of supporting the living standards and quality of life of older people. Full employment can also support the economic inclusion of people who would otherwise struggle to find work, helping to reduce welfare spending in the process.

It is therefore no surprise that full employment is a long-term aim of the UK's Coalition government.<sup>2</sup> This report considers the prospects for achieving that aim following the deep recession of 2008/09. It examines how policy could best support strong private sector growth and job creation in order to hasten a return to full employment. The report focuses in particular on the steps needed to limit long-term unemployment among those put at risk by the recession, particularly young people, older people and those with few qualifications. Long periods out of work can lead to individuals exiting the labour market altogether, which reduces output, wastes human capital and drives increased spending on out-of-work benefits.

An ambitious government should set a long-run employment target of having 80 per cent of the working-age population in work (the remaining 20 per cent being in transition between jobs, unable to work, studying or carrying out caring responsibilities), and this was indeed the aim of the previous Labour government. A look at countries that have a higher employment rate than the UK suggests three interrelated factors are key to such an outcome: a high female participation rate, universal childcare and a large public sector.

However, at its peaks in the 1970s, the 1980s and the 2000s, the employment rate in the UK only reached a high of 73 per cent. In the short term, this is a workable definition of full employment and a reasonable target for government in the next few years. Although employment in the 2008/09 recession fell by less than expected, and has subsequently recovered sooner than expected, the employment rate in the three months to June 2011 stood at just 70.7 per cent (ONS 2011a).

Meanwhile, the Coalition government has embarked on a programme of deficit reduction that will entail substantial cuts in public spending and in the size of the public sector workforce. Opinion is divided about the effect this will have on the UK labour market. The Office for Budget Responsibility (OBR) forecasts an increase in unemployment in the short term, rising from 7.7 per cent in the first quarter of 2011 to 8.2 per cent at the end of 2011, before a gradual decline to 6.2 per cent by the end of 2015 (OBR 2011).

Unless the underlying or structural rate of unemployment has increased, this will leave the UK some way from full employment at the end of 2015 – over six years after growth in the economy resumed following the end of the recession. In the last economic cycle, unemployment fell to lows of around five per cent.

Furthermore, critics argue that private sector demand will not rise fast enough over the next few years to offset the contraction in the public sector and to bring unemployment down as rapidly as forecast by the OBR.<sup>3</sup> They think government policy needs to focus

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2 Lord Freud, welfare reform minister, speaking at the IPPR International Symposium on Welfare to Work, 21 March 2011.

3 See for example outgoing CBI director Richard Lambert's speech on 24 January 2011. <http://www.cbi.org.uk/ndbs/press.nsf/0363c1f07c6ca12a8025671c00381cc7/f84f9fe2a2c4cf2f802578220030e5ca?OpenDocument>



more on promoting growth in output and employment in the private sector in an effort to ensure the UK returns to full employment as quickly as possible.

### Structure of the report

We begin in chapter 2 by setting out recent trends in the UK labour market, focusing on trends in employment, unemployment and inactivity, regional trends, and major changes in the industrial and occupational structure of the labour market over the last 30 years. Chapter 3 explores the likely future trends in employment, addressing concerns about the strength of recovery and job creation, as well highlighting the growth prospects for key industrial sectors.

In chapter 4, we identify those groups who are likely to struggle in the labour market as the recovery moves ahead, as well as highlighting those with long-term structural employment challenges, such as people with long-term health conditions and disabilities. Current policies to support growth and private sector job creation are reviewed in chapter 5, and chapter 6 concludes with recommendations for measures to strengthen job creation in the recovery, promote a return to full employment and ensure that key groups are able to compete in the labour market on more equal terms.

## 2. RECENT TRENDS IN THE UK LABOUR MARKET

The UK labour market has been transformed over the last few decades, with considerable changes in its industrial and occupational structure. This chapter sets out key trends in employment across the UK, focusing on the long-term structural changes that are likely to remain important drivers as the labour market recovers from the 2008/09 recession. We consider how these trends are impacting on the employment prospects of men and women, and the regions and nations of the UK.

### The current structure of UK employment

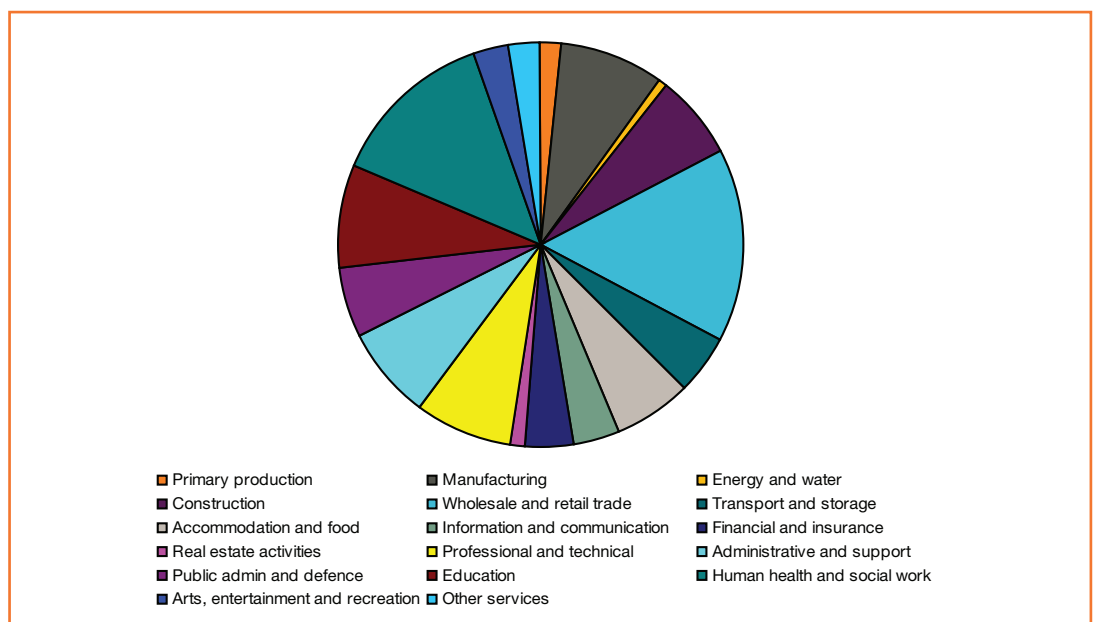
In the first quarter of 2011, the Labour Force Survey (LFS) recorded the UK population aged 16 and over as 50.1 million, of whom 40.1 million were aged 16 to 64. Employment of those aged 16 and over was 29.2 million; unemployment 2.5 million, while 9.3 million aged 16 to 64 were described as inactive (that is not in work and not actively looking for a job).

Since some people have more than one job, the number of workforce jobs in the UK is always a little higher than the level of employment.<sup>4</sup> In the final quarter of 2010 the number of jobs totalled 31.3 million.

Of this total, 25.8 million jobs, or 82.4 per cent, were in service sector industries and just 8.2 per cent in manufacturing, with the remainder in construction, energy and water, and primary production (agriculture and mining). Like most other developed economies, the UK is now dominated by services. As employment expands in the future, the vast majority of new jobs will be created by service industries. Nostalgic hopes for a major revival of manufacturing are likely to be disappointed.

Public administration, education, and health and social work, areas that are mainly, but not exclusively, provided by the public sector, accounted for 27.2 per cent of total workforce jobs. A further 15.3 per cent were in the wholesale and retail trade, with the rest scattered across a broad range of service activities.

**Figure 2.1**  
UK workforce jobs by industry, Q4 2010 (%)

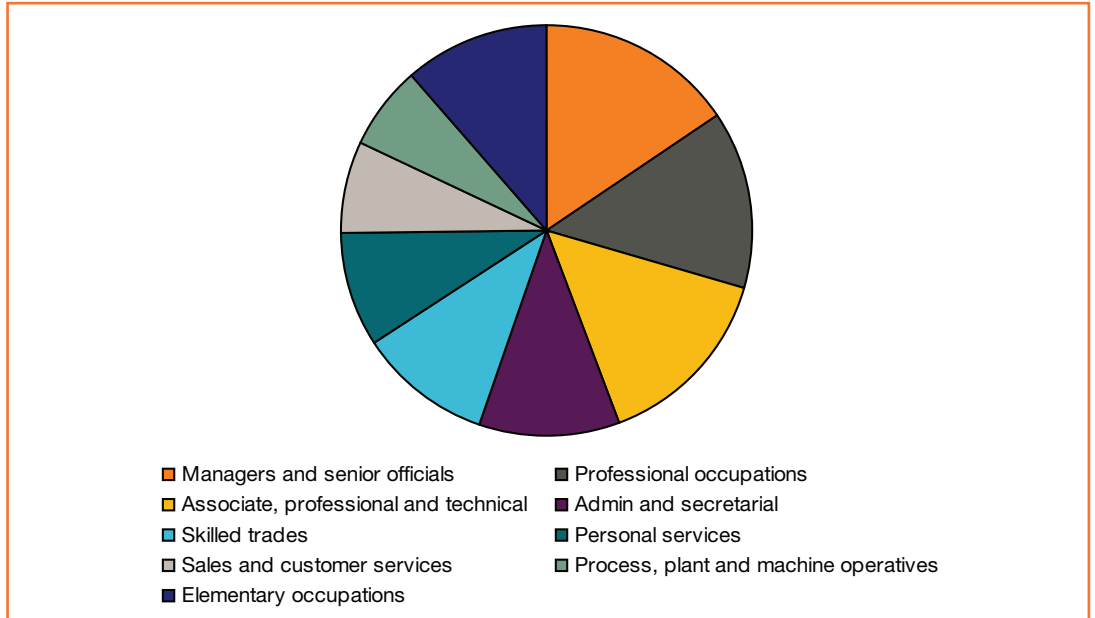


Source: ONS, Labour Force Survey

<sup>4</sup> There are other differences too, for example in the treatment of people in government-supported employment programmes and some self-employed people.

In terms of the broad categories of occupation used by the Office for National Statistics (ONS), managers and senior officials are now the biggest grouping in the UK workforce, accounting for 15.5 per cent of jobs. If managers, professionals, associate professionals and skilled trades are categorised as being ‘skilled workers’, then 55 per cent of employment falls into this category. Increasingly, the UK workforce is becoming more skilled.

**Figure 2.2**  
UK employment by occupation, Q4 2010 (%)

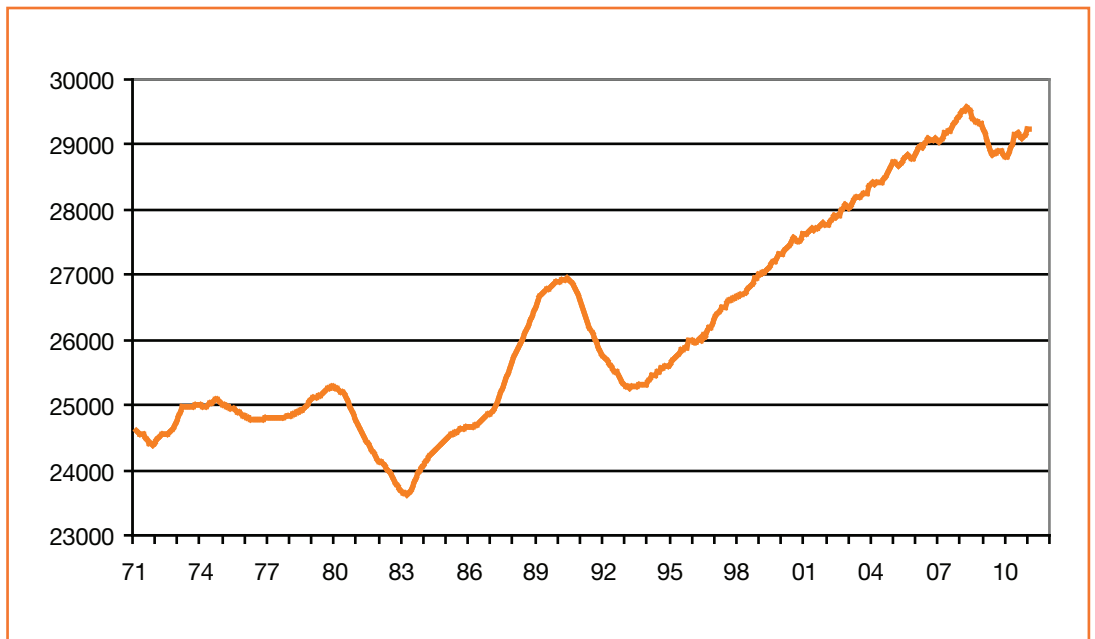


Source: ONS, Labour Force Survey

### Broad employment trends over the last four decades

The UK enjoyed fifteen years of uninterrupted employment growth between 1993 and 2008, with the number in work increasing from under 25.5 million to 29.5 million. As a result the employment rate rose to almost 73 per cent in 2000 and stayed around this level for eight years (matching the peak level seen in 1973–74 and in 1989–90). At the same time, the unemployment rate declined, sharply and steadily from 10.6 per cent in the first quarter of 1993 to 5.1 per cent in the first quarter of 2001 and then more slowly to a low of 4.7 per cent in 2004 and 2005 (its lowest level since 1975). It subsequently edged up to between 5.0 and 5.5 per cent in 2006 and 2007.

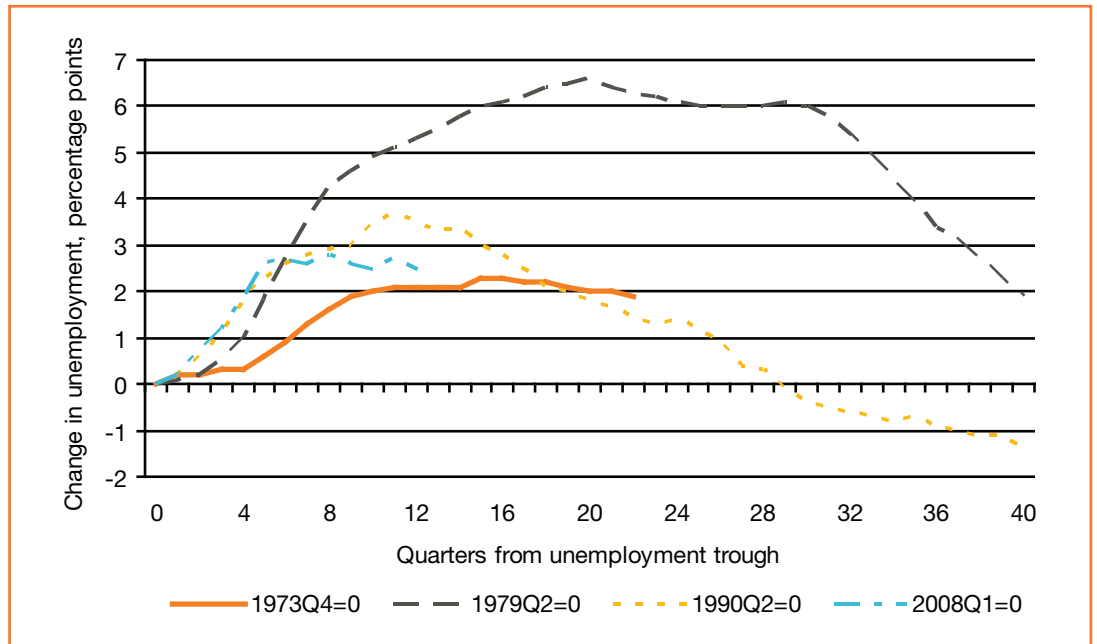
**Figure 2.3**  
Employment in the UK ('000s)



Source: ONS, Labour Force Survey

During the recent recession some of these gains were reversed. Employment fell by 710,000, or 2.4 per cent, from its peak in the second quarter of 2008 to its low in the first quarter of 2010. Unemployment rose from 5.4 per cent to 8 per cent over the same period. However, it could have been much worse. The 2008/09 recession was the longest and deepest in the UK since the 1930s. Real GDP, the total output of the economy, shrank by 6.4 per cent in the space of a year and a half. On the basis of the previous two recessions, when the fall in employment was roughly in line with the fall in output, employment in the current recession might have fallen by two or three times more than it actually did. Furthermore, employment started to recover – and unemployment to decline – in 2010, much sooner than after previous recessions.

**Figure 2.4**  
Increases in the UK unemployment rate during and after recessions



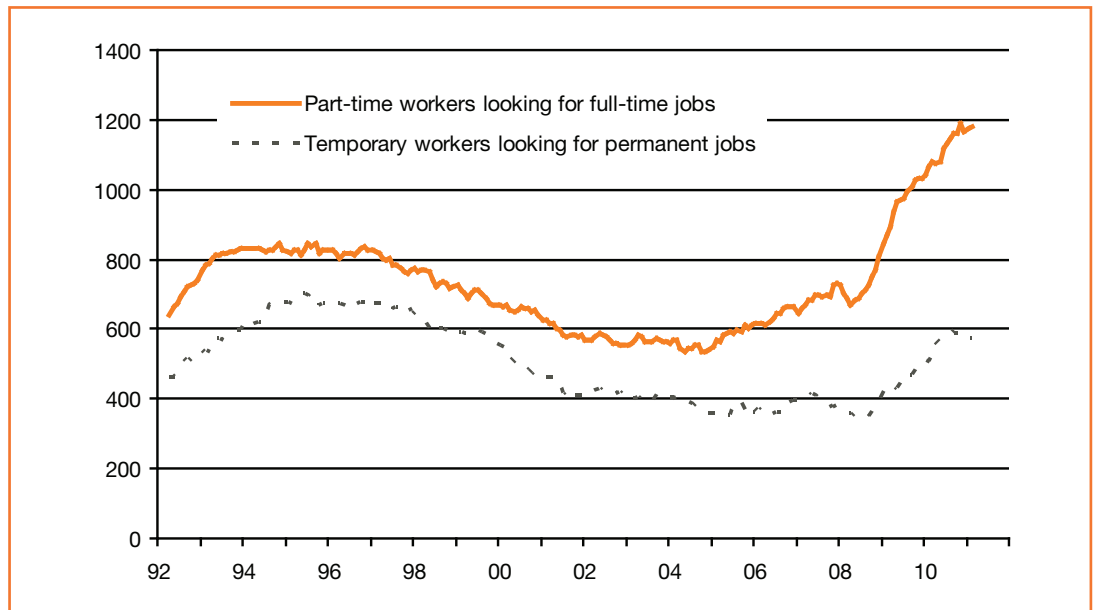
Source: ONS, Labour Force Survey

As a result, although the unemployment rate initially increased during the recession as fast as it had done in the 1990/91 recession (and faster than in the previous two recessions), its increase is now smaller than the increases at comparable points in the recoveries after the last two recessions.

The reasons why unemployment has risen so little, relative to the fall in output, have yet to be fully worked out but it is likely that a number of factors combined to produce this outcome. In part, it may be that output fell most in the sectors of the economy with the highest productivity. There has also been record growth in student numbers over the last three years, as more young people have sought to delay their entry into the workforce. Also important have been a willingness by some employers to regard redundancy as a last resort and a matching willingness by employees to accept low wage increases, part-time working and other changes in their working conditions, rather than to see some of their colleagues lose their jobs.

However, while many employees have accepted part-time work since the recession began, they are not all happy to have done so. In April–June 2011, there were 1,264,000 people working part-time in the UK who said they were only doing so because they could not find full-time work. This is the highest number on record and represents an increase of almost 500,000 since the recession began. There has also been a significant increase in the number of people in temporary employment who are looking for permanent work.

**Figure 2.5**  
Discontented workers in  
the UK ('000s)



Source: ONS, Labour Force Survey

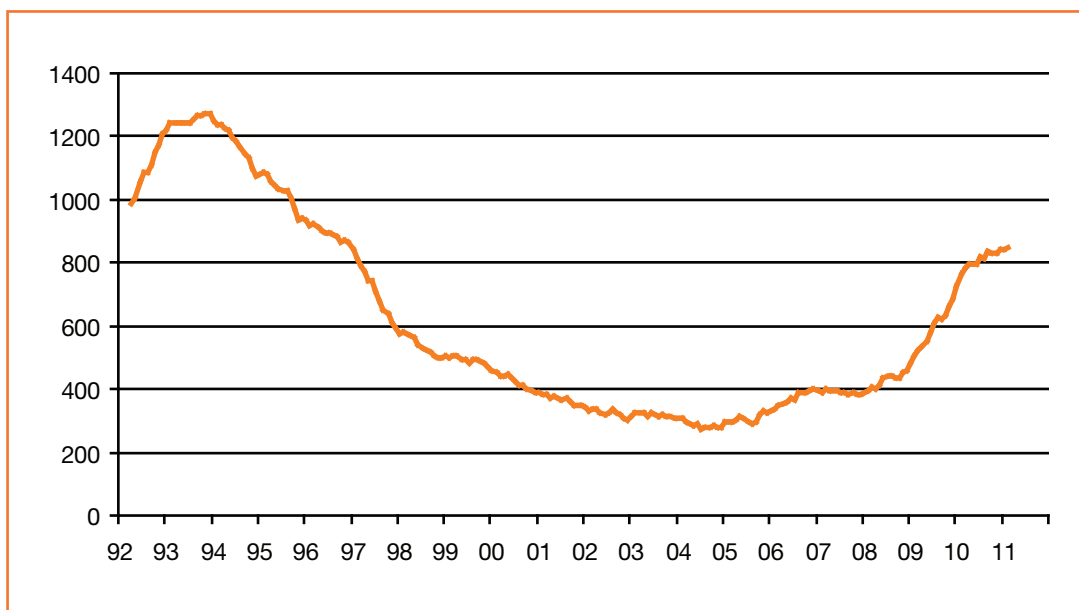
Paul Gregg and Jonathan Wadsworth (2010a) argue that differing international experiences suggest the reason for the UK's surprisingly good employment performance in the recession is not simply a more flexible jobs market. The US, which has a very flexible labour market, experienced big falls in employment rates, while in Germany, which is reckoned to have a less flexible market, unemployment did not increase at all. They argue that reduced outflows from employment, due to wage moderation and increased government spending, explain around two-thirds of the lower-than-expected increase in unemployment, while higher than expected inflows to employment, largely due to active labour market policies, account for the other one-third. This is supported by Eichhorst et al (2010), who also find that wage moderation, reductions in working hours, increases in public sector employment and strong welfare-to-work provision provided relative protection for employment in the UK during the recession.

Active labour market policies, which require people receiving unemployment benefit to take positive steps to find work and also provide more support for them in their endeavours, do therefore seem to have played a part in helping people back into jobs sooner than would otherwise have been the case. This has important implications for future labour market policies, suggesting further initiatives in this area could be an important part of efforts to get the UK back to full employment.

### Long-term unemployment

Long-term unemployment is associated with a 'scarring' effect on future employment and earnings, particularly among young people, and is a key sign of hysteresis in the labour market. Hysteresis occurs when a short-term drop in employment rates persists in the medium to long term. This may be due, for example to workers becoming disillusioned and quitting the labour market, or losing the skills needed to find work. The recession has caused long-term unemployment in the UK (those who have been out of work for more than 52 weeks) to more than double, from around 400,000 in early 2008 to 838,000 in the second quarter of 2011. Long-term unemployment now accounts for over one-third of all unemployment.

**Figure 2.6**  
Long-term  
unemployment in the UK  
('000s)



Source: ONS, Labour Force Survey

This is a particular problem for older workers, who find it difficult to get back into work at a time of labour market slack because they have to compete with younger workers and because they are more likely to have redundant skills. Historically, it has also been a bigger problem for men than women in all age groups (in part reflecting a greater propensity for women who find it hard to get a job to leave the labour force and become inactive).

**Table 2.1**  
Long-term unemployed  
as a share of total  
unemployment, April to  
June 2011

Age group	%
16–17	11.6
18–24	27.4
25–49	38.8
50+	41.5
<b>All</b>	<b>33.6</b>

Source: ONS, Labour Force Survey

The risk of hysteresis is increased by large structural shifts in employment. The UK economy has been losing jobs in the manufacturing sector and creating them in the service sector for many years, but there are no studies of the dynamics of the labour market to show what happened to groups of particular workers and which joined the ranks of the long-term unemployed.<sup>5</sup> It is a reasonable assumption that most former manufacturing workers did not become classroom assistants and care workers, two of the big growth areas in the last decade. But we do not know if they took other jobs in the service sector and displaced, or filled in for, the people previously working in them who did take the new jobs in education and care.

Increases in long-term unemployment are usually associated with increases in structural unemployment.<sup>6</sup> The OECD estimates that the structural unemployment rate in the UK will have increased from 5.3 per cent in 2007 to 5.9 per cent in 2011 (OECD 2010a). In other words, it thinks that – other things being equal – the minimum level of unemployment in the economy is now almost 200,000 higher than it was prior to the recession.

5 Gomes (2009) looks at aggregate flows between employment, unemployment and inactivity in the UK over the period from 1997 to 2007, but he only disaggregates by education (finding those with higher qualifications have more stable employment patterns) and between public and private sectors (coming to no strong conclusion other than that public sector employment is more stable in recessions).

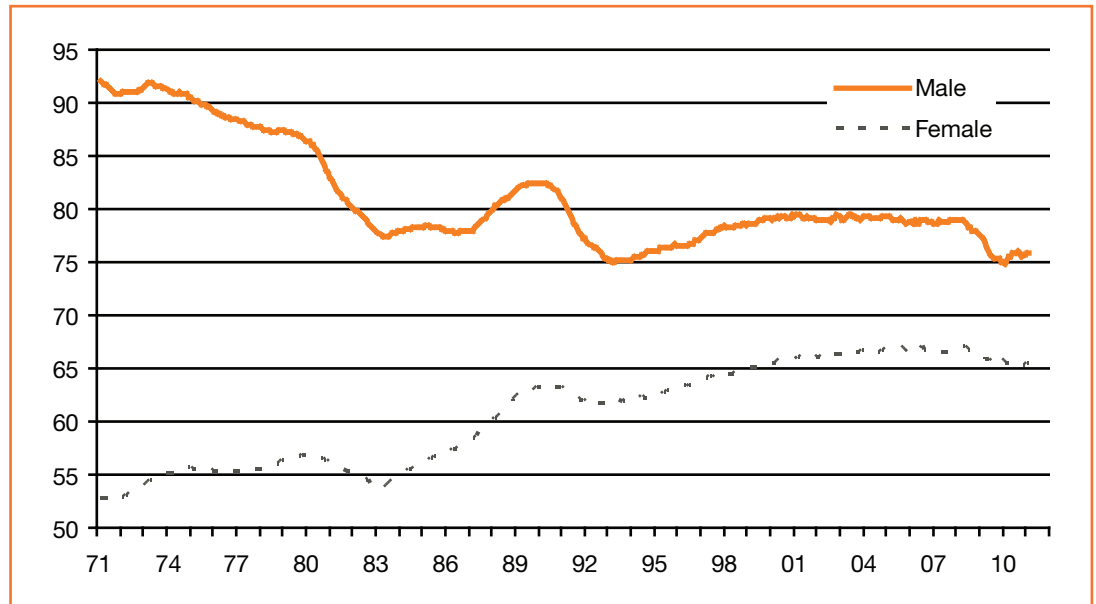
6 Economists often refer to structural unemployment as the non-accelerating inflation rate of unemployment, or NAIRU. If unemployment falls below this level, inflation starts to increase significantly.

## Employment trends by gender

Overall trends in employment mask very significant differences in trends for men and women. Although male employment reached a record high of 15,977,000 in March 2008, just ahead of the onset of the recession, it was up only 386,000, or 2.5 per cent, from February 1971 (when comparable records began). By contrast, female employment increased from 9,022,000 to 13,551,000 over the same period. This represented an increase of 4,529,000, or 50.2 per cent.

Since the onset of the recession, male employment has fallen by 325,000 (2.0 per cent), while female employment is actually up 38,000 (0.3 per cent). This repeats the pattern of job losses in the last two recessions, which also affected male employment rates more than female rates. These considerable differences in the long-term growth rates of male and female employment have resulted in very different trends in employment rates (the percentage of the population aged 16 to 64 in employment). The male employment rate has fallen from 92 per cent at the start of 1971 to 76 per cent, while the female rate has increased from 53 per cent to 66 per cent.

Figure 2.7  
Employment rates, UK (%)

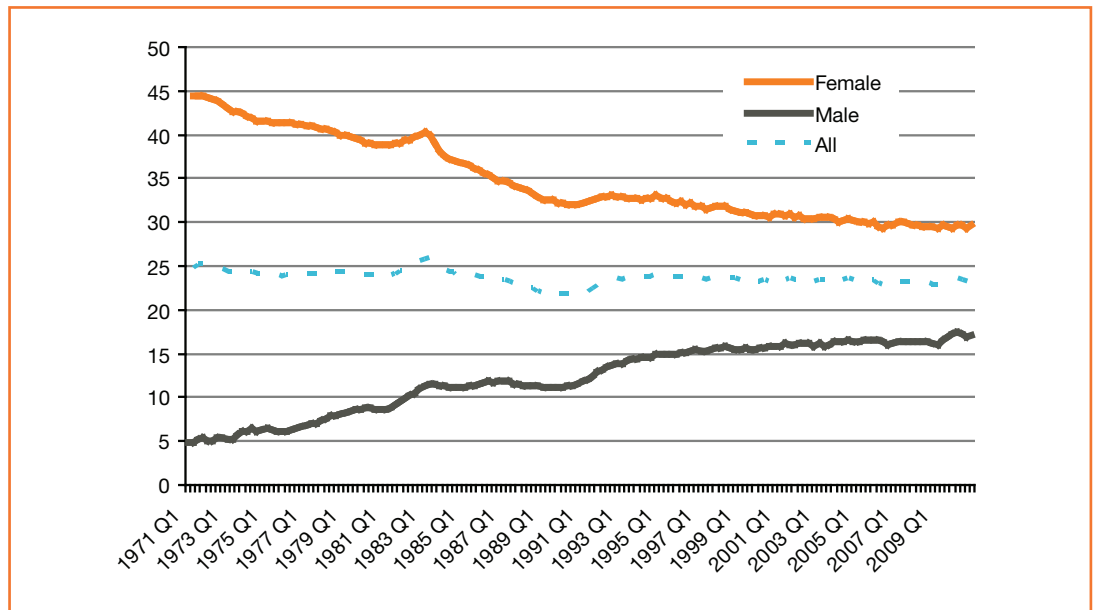


Source: ONS, Labour Force Survey

The changing pattern of employment among men and women is also reflected in long-term trends in economic inactivity. The inactivity rate across the whole working-age population of the UK has remained remarkably static over the last 40 years, at between 22 and 25 per cent. However, this belies considerable changes for both men and women. For men, economic inactivity has increased from an almost negligible five per cent in 1979 to 17 per cent in 2010. Over the same period, female inactivity rates have fallen from 45 to 30 per cent.

Trends in inactivity rates among both men and women are not particularly sensitive to recession and recovery. There was a slight upturn for both men and women just after the start of the early 1980s recession and a fall just before the start of the early 1990s recession. However, the inactivity rate for both men and women has remained largely unchanged since 1992 and has not shown any significant increase as a result of the 2008/09 recession. The decline in employment and increase in inactivity over the long term among men can be attributed to a number of factors. On the positive side, men are joining the workforce later than they used to. Among 16 and 17 year old males, 77 per cent were in full-time education in 2009, compared to 37 per cent in 1985 (Department for Education 2010). Many more young men are going to university, which has drastically reduced the employment rate of those aged 16 to 21 years old.

**Figure 2.8**  
Inactivity rates for  
working-age adults, UK,  
1971–2010



Source: ONS, Labour Market Statistics

On the negative side, the recessions in the early 1980s and early 1990s resulted in sharp drops in employment rates that were never fully reversed, the phenomenon of hysteresis. In the UK, during the 1980s, and to a lesser extent during the 1990s, this was reflected in an increase in the rate of early retirement and a huge increase in the number of people claiming invalidity benefit (which preceded incapacity benefit). This is largely due to the gendered nature of employment by industry. Proportionately, the biggest losses in jobs during the recession and in the early part of the recovery have occurred in manufacturing and construction – two industries which still have a very high proportion of male employees. Meanwhile, employment has continued to increase in the health, education and public administration sector – the only broad sector that has more women than men working in it. Although the fall in the male employment rate in the latest recession was been much smaller than in either of the last two recessions, there is a risk over the next few years that if the economic recovery is a slow one, or a jobless one, hysteresis will again be a factor in the UK labour market.

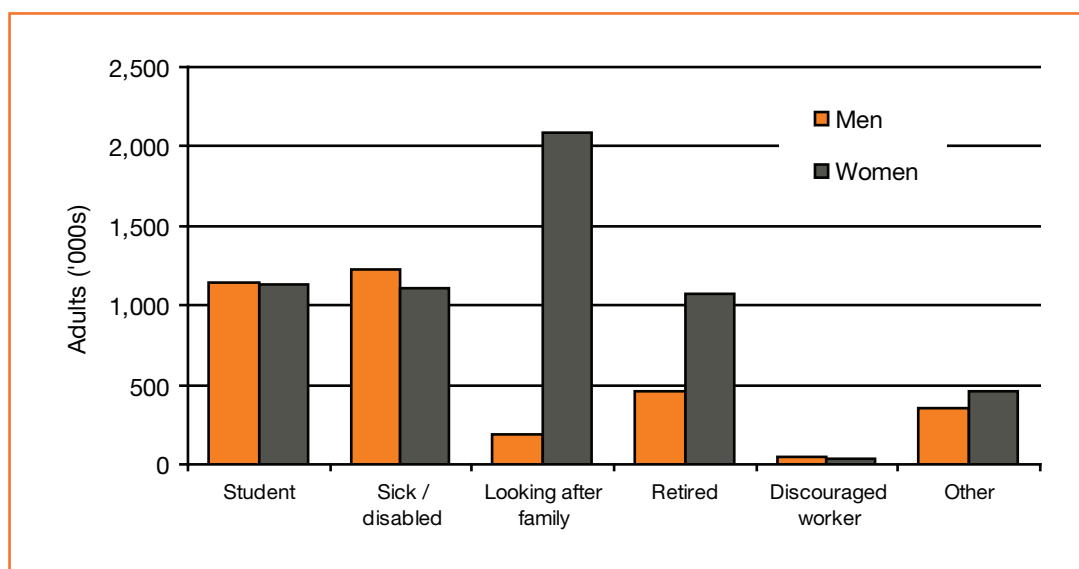
There is little evidence that hysteresis has affected female employment in the UK over the last 40 years. While the employment rate for women fell in the 1980s and 1990s recessions, it soon recovered again. Hysteresis is most likely to affect workers without transferable skills in industries that are in structural decline – in particular large swathes of the manufacturing sector. Employment in these industries has traditionally been dominated by men. So, despite women experiencing similar increases in post-compulsory education take-up rates as men since the early 1970s, the employment rate of women has trended steadily higher. Women have chosen to – and been encouraged to – participate in the labour market in ever greater numbers.

In the first quarter of 2011, there were approximately 9.3 million economically inactive working-age adults in the UK. Just under a quarter of inactive adults (2.3 million) were students and 1.5 million were retired. There were similar numbers of male and female students, but twice as many retired women as men in the 16 to 64 age group due to the historically lower state pension age for women.

Once students and retired people have been stripped out, there are approximately 5.5 million working-age adults who are neither in work nor seeking work. Similar numbers of men and women are inactive due to a disability or ill health – 1.1 million women and 1.2 million men. The largest reason for inactivity among women is looking after a family, which accounts for 2.1 million women.



**Figure 2.9**  
Reasons for inactivity  
among men and women,  
Q1 2011



Source: ONS, Labour Market Statistics

### Employment trends by region and nation

There were distinct regional and national trends in employment growth in Great Britain during the last economic recovery. Over the fifteen years from April 1993 (the trough for employment after the 1990s recession) to April 2008 (the peak for employment ahead of the most recent recession), employment in Great Britain increased by 16.6 per cent. Across the south of England and in Wales, employment growth was stronger; in the Midlands and north of England, and in Scotland, it was weaker.

**Table 2.2**  
Changes in employment  
by region and nation,  
1993–2008 (%)

	April '93 – April '98	April '98 – April '08	April '93 – April '08
North East	1.1	8.9	10.1
North West	0.5	9.0	9.6
Yorks. and Humber	1.6	10.8	12.6
East Midlands	5.9	9.0	15.4
West Midlands	7.1	3.1	10.5
East	7.0	10.3	18.0
London	7.0	18.4	26.7
South East	8.6	8.9	18.2
South West	9.1	11.9	22.0
Wales	4.3	13.3	18.1
Scotland	3.7	11.8	15.9
<b>Great Britain</b>	<b>5.4</b>	<b>10.6</b>	<b>16.6</b>

Source: ONS, Labour Force Survey

This period breaks down into two distinct sub-periods during which the annual rate of employment growth in Britain was similar, but the spatial distribution of growth was very different. In the first five years of recovery, employment increased at an annual rate of 1.1 per cent in Britain. But three regions – the North East, the North West, and Yorkshire and the Humber – all lagged well behind. Over the next ten years, aggregate annual employment growth was 1.0 per cent. In this period, employment growth in London was well above the average, in part reflecting the increasing importance of areas such as finance and business services, while the decline in manufacturing meant that employment growth in the West Midlands lagged well behind the national average. However, across other regions and nations, including in northern England and Wales, employment growth was very similar and close to the average.

There is evidence that employment growth in some of the regions that lagged behind during the last recovery, particularly the North East, Yorkshire and the Humber, the West Midlands, and Scotland, was boosted disproportionately over the period from 1998 to 2008 by increases in public sector employment (Buchanan et al 2009). Growth in private sector employment in these regions continued to fall short of growth in the rest of Britain. If this trend continues, then large areas of the country face a particularly difficult few years. Cuts in public spending will lead to reductions in employment in the public sector, which are likely to fall disproportionately on these regions and any growth in private sector employment could well be slower too. The result could be an increased spatial polarisation of employment growth – relatively depressed in much of the north of Britain, with any increase in jobs concentrated in the south.

### Employment trends by industry

Over the 15 and a half years between the fourth quarter of 1992, at the end of the early 1990s recession, and the employment peak in the second quarter of 2008, as the economy entered the most recent recession, employment in the UK increased by 4.8 million, or 18 per cent. Over this period, employment in production industries contracted and there was a drop of almost 1.3 million in the number of employees in manufacturing. This contraction was more than offset by higher employment in service industries. Employment in construction also rose.

**Table 2.3**  
Changes in employment  
by industry, Q4 1992  
– Q2 2008

	Employment ('000s)		Change	
	Q4 1992	Q2 2008	'000s	%
Agriculture, forestry and fishing	566	412	-154	-27
Mining and quarrying	106	68	-38	-36
Manufacturing	4,159	2,872	-1,287	-31
Electricity, gas etc	163	87	-76	-47
Water supply, sewerage etc	168	168	0	0
Construction	1,974	2,304	330	17
Wholesale and retail trade	4,519	5,046	527	12
Transport and storage	1,260	1,534	274	22
Accommodation and food service	1,632	2,012	380	23
Information and communication	754	1,202	448	59
Financial and insurance activities	1,119	1,189	70	6
Real estate activities	219	444	225	103
Professional, scientific and technical	1,292	2,270	978	76
Administrative and support	1,583	2,565	982	62
Public administration and defence	1,844	1,750	-94	-5
Education	1,970	2,610	640	32
Human health and social work	2,734	3,751	1,017	37
Arts, entertainment, recreation	618	907	289	47
Other service activities	592	871	279	47
<b>Total</b>	<b>27,273</b>	<b>32,068</b>	<b>4,790</b>	<b>18</b>

Source: ONS, Labour Force Survey

The biggest growth areas, in terms of absolute numbers, were employment in human health and social work, in administrative and support services, and in professional, scientific and technical industries, (which together accounted for two-thirds of net job creation over this period), but there were increases in employment across all areas of the service sector bar public administration and defence. There was also a substantial percentage increase in employment in real estate activities.

The recession and subsequent hesitant recovery have seen some of these trends extended, while others were reversed. The main trend that was extended was the loss of jobs in manufacturing. Since the start of the recession, a further 323,000 jobs have gone in this industry, lifting the total to over 1.6 million in less than 20 years. But there have also been substantial job losses in wholesale and retail trades, construction, and administrative and support services, which were all previously growth areas. Only in three areas – human health, professional, scientific and technical industries, and education – were there significant increases in employment during the last two years. As the vast majority of jobs in two of these areas are in the public sector, the role of government spending in preventing the recession from having a bigger impact on the labour market is clear.

**Table 2.4**  
Changes in employment  
by industry, Q2 2008  
– Q4 2010

	Employment ('000s)		Change	
	Q2 2008	Q4 2010	'000s	%
Agriculture, forestry and fishing	412	475	63	15
Mining and quarrying	68	62	-6	-9
Manufacturing	2,872	2,549	-323	-11
Electricity, gas, etc	87	135	48	55
Water supply, sewerage etc	168	154	-14	-8
Construction	2,304	2,128	-176	-8
Wholesale and retail trade	5,046	4,776	-270	-5
Transport and storage	1,534	1,458	-76	-5
Accommodation and food service	2,012	1,917	-95	-5
Information and communication	1,202	1,150	-52	-4
Financial and insurance activities	1,189	1,131	-58	-5
Real estate activities	444	428	-16	-4
Professional, scientific and technical	2,270	2,383	113	5
Administrative and support	2,565	2,320	-245	-10
Public administration and defence	1,750	1,730	-20	-1
Education	2,610	2,671	61	2
Human health and social work	3,751	4,106	355	9
Arts, entertainment, recreation	907	868	-39	-4
Other service activities	871	818	-53	-6
<b>Total</b>	<b>32,063</b>	<b>31,260</b>	<b>-803</b>	<b>-3</b>

Source: ONS, Labour Force Survey

More detailed data on employment by sub-industry is available from 1996. Looking at the whole of the period from the fourth quarter of 1996 to the fourth quarter of 2010 reveals a clearer picture of where jobs were gained and lost.<sup>7</sup> Table 2.5 highlights those industries with the largest increases in employment over this period. Again the important role played by public sector employment is clear, with health, education, social work and public sector administration all featuring. The consumer boom is also apparent in the growth in employment in some areas of retailing and restaurants (though other areas of retailing lost many jobs).

<sup>7</sup> Data at this level of disaggregation is only available on a not seasonally adjusted basis, so only full-year comparisons are valid.

**Table 2.5**  
Changes in employment  
in selected industries, Q4  
1996 – Q4 2010

	Employment ('000s)		Change	
	Q4 1996	Q4 2010	'000s	%
Human health activities	1,422	2,051	629	44
Education	1,882	2,342	460	24
Activities of head offices; management consultancy	180	554	374	208
Retail sale in non-specialised stores, food, beverages and tobacco predominating	733	1,065	332	45
Social work activities without accommodation	659	944	285	43
Temporary employment agency activities; other human resources	358	628	270	75
Restaurants and mobile food service activities	418	652	234	56
Activities auxiliary to financial services and insurance activities	209	422	213	102
Computer programming, consultancy and related services	237	427	190	80
Specialised construction activities	510	676	166	33
Retail sale of clothing, footwear and leather goods in specialised stores	292	436	144	49
Sports activities and amusement and recreation activities	269	400	131	49
Public administration and defence; compulsory social security	1,322	1,451	129	10
Real estate activities on a fee or contract basis	82	188	106	129
Residential care activities	523	626	103	20

Source: ONS, Economic and Labour Market Review

The strong growth in the number of people employed in computer programming and related activities shows that technological progress does not just destroy jobs in some industries, it also creates them in others. This is a trend that can be expected to continue in the future. The growth in the number of people working in residential care – a reflection of the ageing of the UK's population also stands out – and is another trend that will surely be maintained in coming years. There was also a large increase in people working in activities 'auxiliary to financial services and insurance activities'. This includes most activities of investment banks, asset managers and hedge funds. It is less certain that growth in this area will persist in the future.

Table 2.6 shows the sub-industries where most jobs have been lost since 1996. Three things stand out. First, 12 of the 18 categories are areas of manufacturing (the decline in manufacturing employment is looked at in more detail below). Second, two categories cover retailing in specialist shops. This is the result of a shift in shopping habits, away from small shops and towards supermarkets. Third, there is one category within financial services (insurance, reinsurance and pension funding) where a significant number of jobs were lost, suggesting the financial boom in the 2000s (prior to the recession) may not have been reflected in the labour market (this is also covered in more detail below).

**Table 2.6**  
Changes in employment  
in selected industries, Q4  
1996 – Q4 2010

	Employment ('000s)		Change	
	Q4 1996	Q4 2010	'000s	%
Manufacture of machinery and equipment not classified elsewhere	304	147	-157	-52
Manufacture of wearing apparel	167	24	-143	-86
Retail sale of food, beverages and tobacco in specialised stores	266	123	-143	-54
Manufacture of fabricated metal products	439	298	-141	-32
Manufacture of computer, electronic and optical products	246	115	-131	-53
Insurance, reinsurance and pension funding	213	90	-123	-58
Manufacture of motor vehicles, trailers and semi-trailers	247	129	-118	-48
Manufacture of textiles	160	56	-104	-65
Printing and reproduction of recorded media	215	118	-97	-45
Manufacture of electrical equipment	152	64	-88	-58
Manufacture of basic metals	150	63	-87	-58
Manufacture of rubber and plastic products	240	162	-78	-33
Manufacture of chemicals and chemical products	169	95	-74	-44
Retail sale of other household equipment in specialised stores	307	239	-68	-22
Event catering and other food service activities	254	190	-64	-25
Manufacture of paper and paper products	107	48	-59	-55
Repair and installation of machinery and equipment	150	92	-58	-39
Manufacture of other non-metallic mineral products	145	92	-53	-37

Source: ONS, Economic and Labour Market Review

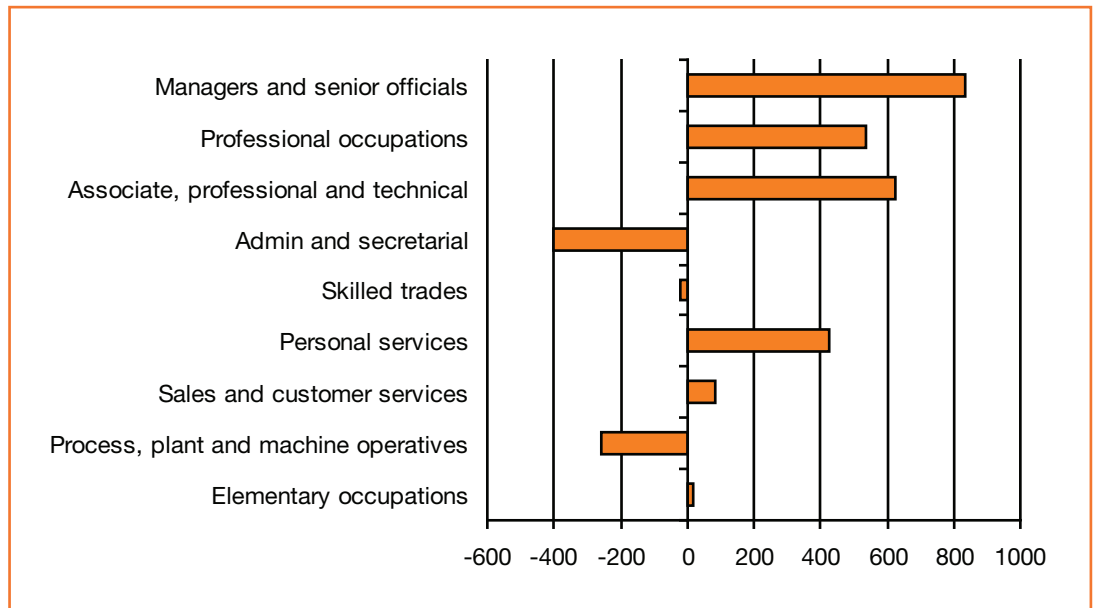
### Employment trends by occupation

A breakdown of employment by occupation on the current basis used by the ONS is available from the second quarter of 2001. Over the seven years from this date – to the peak in employment before the recession – employment increased by 1.8 million in the UK. By the second quarter of 2008 there were two million more managers and senior officers, professionals, associate professionals and technical staff, and over 400,000 more people working in personal services. However, there were also 400,000 fewer administrative and secretarial workers, and 260,000 fewer process, plant and machine operatives.

The fall in administrative and secretarial workers might appear odd, given that employment in the administrative and support services sector has grown rapidly over the last decade. The likely explanation is that the former covers all workers occupied in administration or secretarial roles; the latter refers to the administrative and support services industry. Over this period, technological advances have allowed companies to reduce the number of people they employ directly in these roles. But at the same time, when this type of work

is needed it is increasingly contracted out to other firms. Hence, there are fewer people overall doing this type of work, but more of them employed in the industry that specialises in it.

**Figure 2.10**  
Change in UK  
employment by  
occupation, Q2 2001  
– Q2 2008 ('000s)



Source: ONS, Labour Force Survey

For the most part, these trends in employment by occupation continued during the recession and in the early stages of the recovery. Between the final quarter of 2007 and the final quarter of 2010, 207,000 administrative and secretarial jobs were lost, as were 224,000 process, plant and machine operative roles.<sup>8</sup> Meanwhile, there were further increases in professional, associate professional and personal service jobs, and in the number of managers and senior officials.

Through boom, bust and recovery, therefore, the underlying trend is clearly away from semi-skilled and some unskilled jobs – both in manufacturing and services – and in favour of more skilled jobs in the service sector.

Both men and women have been affected by these trends, though in different ways. Women account for all of the administrative and secretarial jobs lost over the last nine years; while men account for 60 per cent of the reduction in process, plant and machine operatives. Women have taken 76 per cent of the new jobs created in personal services and 62 per cent of new managerial, professional and associate professional posts.

There are two underlying factors behind these trends in employment by occupation: overseas competition and technological change. Low value-added manufacturing firms in the UK have been finding it increasingly difficult to compete with companies in emerging economies in recent years and many have closed or transferred production overseas. Others have stayed in business by making greater use of technology to replace workers, so boosting productivity and preserving profit margins. This explains why there have been significant declines in the number of process, plant and machine operatives.

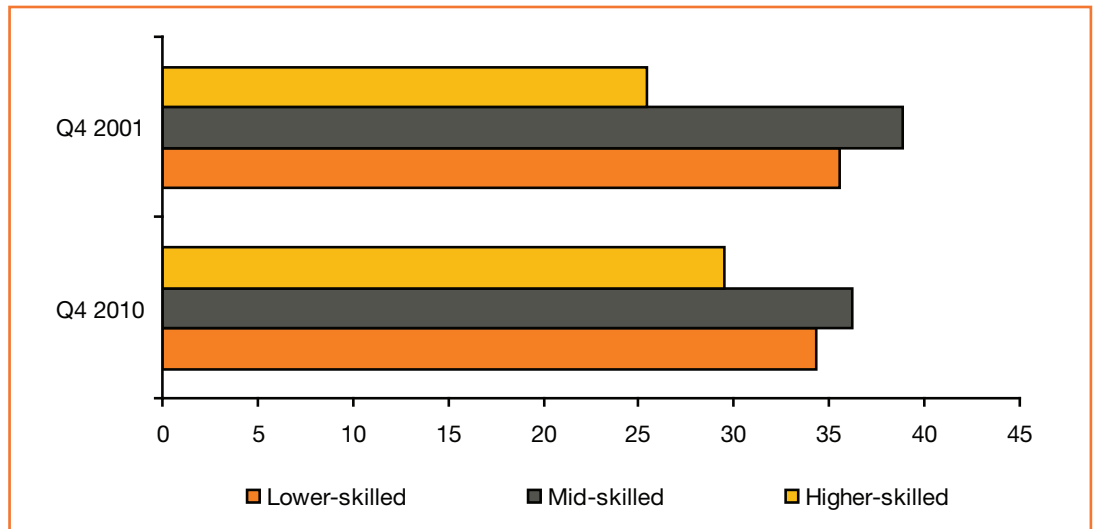
Similar trends are at work in the service sector, where companies have also transferred some functions overseas. This can range from relatively low-skilled work, such as insurance companies' call centres, to more complex tasks, such as corporate analysis for investment banks. Employers in the service sector have also taken advantage of the ability of more powerful computers and software to perform a wide range of functions previously undertaken by administrative staff in retail banks.

<sup>8</sup> Data on employment by occupation is only available on a not-seasonally-adjusted basis, so only full year comparisons are valid.

There is evidence that technological change has its biggest effect on middle-skilled, middle-income occupations. The Economist magazine highlighted several studies which show how computers complement the work of high-skilled workers, by improving their use of their skills and abilities, and are unable to replace many low-skilled jobs that are hard to mechanise.<sup>9</sup> The result is that labour markets in many developed economies have become ‘polarised’ over the last 20 to 30 years. There are proportionately more high-income, high-skilled jobs, and more low-income, low-skilled jobs, but fewer middle-income, middle-skilled jobs.

This is only half-true over the last decade in the UK. There were over 1.5 million more high-skilled jobs in the UK at the end of 2010 than there were nine years earlier. Over the same period, the number of lower-skilled jobs increased by only 100,000, while the number of mid-skilled jobs fell by 250,000. Rather than polarisation, therefore, the UK has seen shrinkage in the proportion of mid-skilled jobs, a smaller drop in the proportion of low-skilled jobs, and an increase in the proportion of jobs that are high-skilled jobs. And there are still more mid-skilled jobs than either of the two other types.

**Figure 2.11**  
Employment by skill level, percentage of total employment



Source: ONS, Labour Force Survey<sup>10</sup>

Neither globalisation nor technological change is wholly negative for overall levels of employment in the UK. Increasing incomes and demand in emerging economies should create opportunities for UK firms to boost exports of goods and services. However, the evidence to date is that they have been slow to exploit these opportunities and the UK’s share of trade to the largest emerging economies (Brazil, Russia, India and China – also known as the BRIC economies) is well below its share of world trade (Lent and Nash 2011). In part, this may be due to sterling being overvalued from 1997 to 2007 while these economies were growing strongly. If so, the picture might improve following sterling’s depreciation in 2007 and 2008. But there could also be a structural problem that will be harder to overcome. The UK may now be poorly placed to produce the types of goods these countries are demanding, such as capital goods and precision machine tools.

These trends seem sure to continue in coming years. Competition from overseas will intensify as firms in emerging economies seek to move up the ‘value-chain’ – moving into new areas of manufacturing (and services) where they will be competing with UK companies. And there is no sign that the exponential growth of computing power (as described by Moore’s law<sup>11</sup>) is about to halt. As a result, the loss of traditional unskilled and semi-skilled jobs will continue.

9 The Economist, ‘Economics Focus: Automatic Reaction’, issue dated 11 September 2010, page 78

10 Higher-skilled = management, senior officials and professional occupations; mid-skilled = associate professional and technical, administrative and secretarial, and skilled trades; lower-skilled = personal services, sales and customer services, process, plant and machine operatives, and elementary occupations.

11 Moore’s law states that the number of transistors that can be placed on a computer chip roughly doubles every year, driving an exponential growth in computing power.

The UK's changing pattern of employment is explained well by the taxonomy developed by Guy Michaels to help understand the effect of technological change on various types of work.

**Table 2.7**  
Taxonomy of tasks

Task type		Task description	Examples of occupations	Education levels	Effect of information and communication technology (ICT)	Change in demand
Routine	Manual	Rules based, repetitive, procedural	Assembly line workers	Low	Direct substitution	Down
	Non-manual	Rules based, repetitive, procedural	Clerical, book-keepers	Middle	Direct substitution	Down
Non-routine	Manual	Environmental and interpersonal adaptability	Security guards, waiters, drivers	Low	Broadly neutral	Zero
	Non-manual	Abstract problem-solving, mental flexibility	Managers, doctors, lawyers, scientists	High	Strongly complementary	Up

Source: Michaels 2010

With colleagues, he has shown that those countries and those industries across countries that have invested most in ICT have seen the biggest increase in demand for workers with high education levels relative to those with middle education levels, but have not seen much of a change in the number of workers with the lowest educational achievement (Michaels et al 2009). Consequently, they reject alternative explanations for the polarisation of workforces, such as the decline of trade unions or the introduction of minimum wages.

Michaels et al (2009) also reject the idea that globalisation has any independent effect on polarisation: 'We find that the positive correlation between trade openness and the increased demand for high-skilled workers relative to middle-skilled disappears once we control for technological change' (Michaels 2010: 26).

In other words, if globalisation has any effect at all, which it might not, it is through encouraging a faster implementation of new technologies. This conclusion is supported by Goos et al (2010), who conclude from a study of 16 European countries that 'routinisation' – the replacement of human capital by technology in the performance of routine tasks – is the most important driver of polarisation.

The Economist suggests this could have important implications for public policy. If it is accepted, that mid-skilled jobs are disappearing due to a lack of demand, not as a result of a failure of the education system to produce enough people with the right skills (and the fact that these trends are evident across a range of countries suggests this is likely to be the case), there would appear to be less point in encouraging young people to develop middle-level skills.

However, it is also important to note that roughly one in three people are likely to still be employed in mid-skilled jobs in 2020. So it would be wrong to discourage young people from developing middle-level skills. There will still be a vital role for further education in providing the learning, for example as part of apprenticeships, needed to fulfil some of these jobs.

The last government had a target of getting 50 per cent of young adults to attend higher education, though the actual proportion is still closer to 40 per cent. This target brought accusations that more and more students were studying for degrees that would do little to boost their earnings power. It has been dropped by the Coalition government, which will also allow top-up fees of up to £9,000 from 2012–13,<sup>12</sup> a move that could see demand for

<sup>12</sup> In England and Wales. Students living and studying in Scotland do not have to pay university fees.



higher education fall. However, if the trend of the last decade continues, by 2020 around 35 per cent of the UK's workforce will be in high-skilled jobs and for the first-time there will be more high-skilled jobs than either mid- or low-skilled jobs. Demand for young people with degrees will, therefore, probably increase. Of course, there is no one-for-one link between having a degree and working in a high-skilled job. Some people without a degree will have high-skilled jobs; some people with a degree will have mid- or low-skilled jobs. As a target, 50 per cent may well have been too high, but cutting the number of young people going to university would seem to be inappropriate given current trends in the labour market.

## Conclusion

This examination of the current structure of the UK labour market and of trends over the last 10 to 20 years has produced several pointers to likely developments over the next decade.

First, now that over four-fifths of employment in the UK is based in the service sector of the economy, it should be clear that any 'rebalancing' of the economy, or revival of manufacturing industry, can have only a limited impact on aggregate employment levels. The manufacturing sector is simply no longer big enough to soak up a significant number of people joining the labour market each year, never mind the extra numbers made unemployed as a result of the recent recession. New jobs in the future will be found predominately in the private service sector of the economy.

Second, technological change and, to a lesser extent, globalisation are having profound effects on the structure of the UK workforce and these effects are very likely to be sustained into the foreseeable future. More job opportunities are being created for high-skilled workers, including managers, professionals, scientists and computer programmers, but many mid-skilled and low-skilled jobs are being lost.

Third, other structural changes, particularly the ageing of the population, will continue to create new opportunities for low-skilled workers, for example in social and health care, but if past trends are maintained, fewer new opportunities will be available for mid-skilled workers.

Fourth, these changes are producing differing opportunities for workers across the regions of the UK. Regions that relied relatively heavily on low-value-added manufacturing for employment in the past and have struggled to develop sufficient new job opportunities in the private service sector will remain particularly vulnerable to further technological change. These include Scotland, the North East, Yorkshire and the Humber, and the West Midlands, in particular.

A better understanding of how these trends might develop over the next decade requires analysis of employment projections and of likely trends in key sectors of the economy. It is to these that we turn next.

### 3. PROSPECTS FOR THE UK LABOUR MARKET OVER THE NEXT DECADE

In this chapter, we consider how the UK labour market is likely to evolve over the next decade. The initial focus is on the likely strength of the recovery, and the level of job creation that may be associated with the projected recovery. We then turn to the major sectors within the UK economy to assess which sectors can be expected to deliver the greatest employment growth.

#### Broad employment trends

Economists refer to the relationship between real GDP growth and the change in unemployment as Okun's law.<sup>13</sup> It shows how much growth has, on average, been associated with falling unemployment in the past. History suggests the UK economy needs to grow at an annual rate of at least 2.5 per cent if unemployment is to fall.<sup>14</sup>

During the recession, some economists worried that, if firms were hoarding labour or saving costs through the increased use of part-time working, then their first reaction when demand for their products picked up would be to make use of the under-used labour and to re-employ people full-time. To the extent that this occurred, increases in output in the short term may not have been fully reflected in increases in employment or declines in unemployment. In fact, the latest data suggest the opposite is happening: jobs creation without growth. The latest data, for Q2 2011, show GDP growth of 0.8 per cent and a rise in unemployment of just 0.1 percentage points over the last year – a better unemployment outcome than that suggested by history. John Philpott thinks this is evidence of more hoarding (2011). If so, there will eventually be a period of stronger growth that will have little impact on the labour market.

The OBR appears not to believe this will be the case. Its latest forecasts – published in March 2011 – show average real GDP growth of 2.6 per cent over the next five years, average employment growth of 0.7 per cent and a decline in unemployment of almost two percentage points (OBR 2011). This implies productivity (output per person) growth of 1.9 per cent a year over the next five years, a little above the UK's long-run average productivity growth.

**Table 3.1**  
OBR economic forecasts

	2010	2011	2012	2013	2014	2015
Real GDP growth (%)	1.3	1.7	2.5	2.9	2.9	2.8
Employment (millions)	29.0	29.0	29.2	29.5	29.7	30.0
Employment growth (%)	0.0	0.0	0.7	1.0	0.7	1.0
ILO unemployment rate (%)	7.9	8.2	8.1	7.6	7.0	6.4

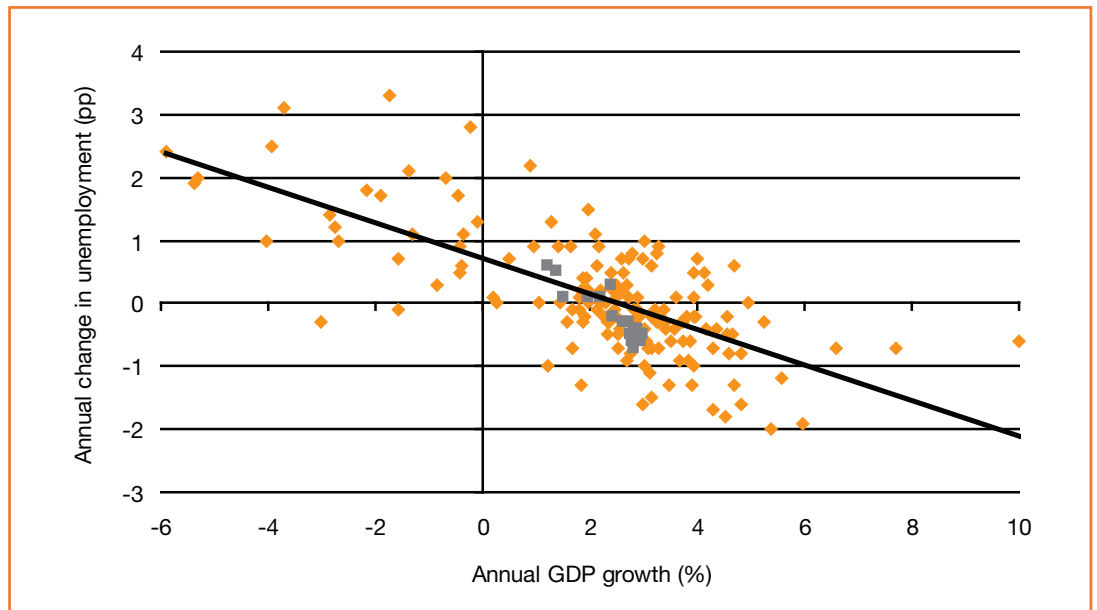
Source: OBR 2011

The relationship assumed by the OBR between real GDP growth and unemployment looks a little on the optimistic side and the risk is that, if its growth forecasts are right, unemployment will fall a little less than it expects. Even if the OBR is right, employment will not exceed its previous peak until 2014, and the unemployment rate in 2015 will be still be over one percentage point higher than it was before the onset of recession in 2008. Full employment will still be some way off.

<sup>13</sup> After the American economist Arthur Okun.

<sup>14</sup> See the appendix for statistical analysis of this relationship.

Figure 3.1  
Okun's law – the  
relationship between  
real GDP growth and the  
change in unemployment  
– with OBR forecasts to  
Q1 2016



Source: ONS, Labour Force Survey and National Accounts, and OBR

Independent forecasters monitored by HM Treasury are less optimistic than the OBR. When they were last asked for their medium-term projections, they predicted that the claimant count measure of unemployment would remain above 1.5 million in 2011 and 2012 (it averaged 1.52 million in 2010), before dropping – but only to 1.4 million by 2015.<sup>15</sup>

One worry is that many workers who lost their jobs in the recession have the wrong skills needed for the future UK labour market. Despite the origins of the recession being in the financial sector, 500,000 jobs have been lost in manufacturing and construction – most of them previously filled by men – since the recession began and, for all the talk of rebalancing the economy, it unlikely that many jobs will be recreated in these industries over the next few years. If, instead, the private service sector is the source of most new jobs in the economy, former manufacturing and construction workers are likely to find it hard to adapt to them. Unemployed workers' skills will start to become obsolescent because they are no longer receiving on-the-job or other training. As a result they could become demoralised and stop actively looking for work. This type of skills mismatch could lead to a permanent decrease in employment rates for men and a consequent loss of productive potential for the UK economy. As jobs are cut in the public sector, the employment rate of women could also fall and for the first time in the UK in modern times, hysteresis effects could mean that this fall is hard to reverse.

Limits to geographical mobility may have a similar effect in lifting long-term unemployment, and eventually inactivity rates. New jobs may be more easily created in some parts of the country, while relatively high levels of unemployment are found in other parts. There are costs – financial and emotional – to moving home in order to find work and some people may judge them to be too high, resulting in a geographical mismatch between job vacancies and unemployment.

Analysts have also demonstrated that the level of labour supply is likely to increase dramatically over the next decade as a result of demographic changes and new benefit rules transferring people from inactivity to active participation in the labour market. Gregg and Wadsworth (2011) have calculated that the size of the working-age population will grow by 200,000 a year over the next decade, and the number of older workers staying in the labour market will also increase by 200,000 each year. At the same time, the Coalition's benefit reforms are designed to move around 800,000 from inactive disability benefits into the labour market over the next four years. The level of job creation required

<sup>15</sup> HM Treasury (2011). The original document shows one forecast for unemployment of 0.11 million in 2015. We have assumed this is a printing error, excluded that forecast and recalculated the average.

to satisfy this rising supply will be much greater than is suggested by simply considering the rise in unemployment generated by the recession.

### Projections of employment by industry

In December 2008, the UK Commission for Employment and Skills (UKCES) published an analysis by the Institute for Employment Research (IER) at the University of Warwick of likely employment trends in the UK over the decade from 2007 (Wilson et al 2008). These suggested that aggregate employment in the UK would increase by almost two million, or 6.2 per cent, between 2007 and 2017. This is the equivalent of 0.6 per cent a year. The subsequent recession has seen employment contract. Forecasters, including the OBR, do not expect it to return to its 2007 level until around 2013. It would, therefore, take extraordinary growth in employment between 2013 and 2017 for the IER forecast to be achieved (employment would have to increase at an annual rate of 1.5 per cent).

Although the IER's aggregate forecasts are therefore very likely to prove too optimistic, its results are still interesting as a representation of mainstream thinking on the direction of the industrial composition of the UK labour market. Broadly speaking, the IER expect a continuation over the period from 2007 to 2017 of the trends of the previous decade – but at a slower pace. Thus, employment in manufacturing is expected to fall by 1.4 per cent a year, rather than 3.3 per cent, and employment in business and other services to increase by 1.4 per cent rather than 2.6 per cent. Even so, by 2017, 83.1 per cent of employment would be in services, compared to 80.7 per cent in 2007.

**Table 3.2**  
Employment by broad sector in the UK, 1987–2017 ('000s)

Employment level	1987	1997	2007	2017
Primary sectors and utilities	1,106	814	633	503
Manufacturing	5,165	4,473	3,181	2,750
Construction	1,990	1,730	2,187	2,361
Distribution and transport	7,419	8,203	8,881	9,418
Business and other services	5,102	6,604	8,573	9,879
Non-marketed services	5,859	6,404	7,780	8,273
<b>Total</b>	<b>26,642</b>	<b>28,227</b>	<b>31,234</b>	<b>33,184</b>

Net changes	1987–97	1997–07	2007–17
Primary sectors and utilities	-293	-180	-130
Manufacturing	-692	-1291	-432
Construction	-260	456	175
Distribution and transport	784	678	537
Business and other services	1,502	1,969	1,306
Non-marketed services	545	1375	494
<b>Total</b>	<b>1,585</b>	<b>3,008</b>	<b>1,949</b>

Source: Wilson et al 2008

The IER's projections are the result of detailed analysis of the outlook for output growth and productivity in each sector of the economy. Their bottom line is that the economy will not rebalance in the way that government hopes. Manufacturing output is expected to grow less rapidly than GDP; service sector output, particularly in the non-financial business service sector, to grow faster. Meanwhile, technological change and the need to remain competitive will drive productivity growth to be faster in those parts of the economy, including most of manufacturing industry, open to competition from overseas. As a result, the gap between employment growth in services and manufacturing will be even wider than the gap between output growth in the same sectors.

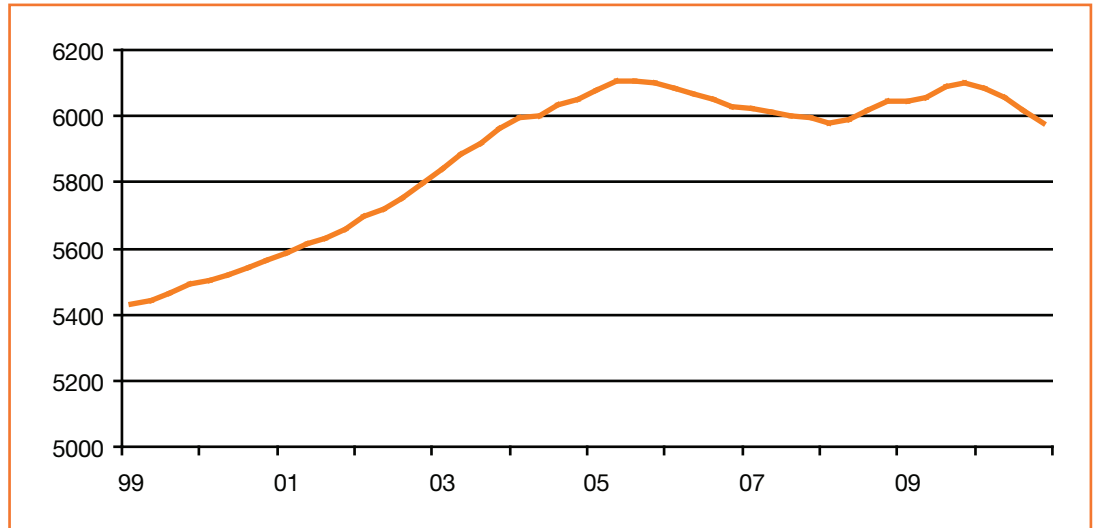
Such projections, which to a large extent reflect historical trends, are however of limited use, particularly when the economy has been through a traumatic event like the financial

collapse and recession. Careful consideration needs to be given to possible developments in key sectors.

### Public sector employment

The most significant change in UK employment trends over the next few years will occur in the public sector. The government's public spending plans for the next four years, as set out in October 2010, envisage an eight per cent cut in departmental spending between 2010/11 and 2014/15 (HM Treasury 2010). Inevitably, this will lead to job cuts – indeed the latest figures show public sector employment was already falling in 2010.

**Figure 3.2**  
Public sector employment (excluding publicly-owned financial corporations) ('000s)



Source: ONS, Labour Force Survey

Local government accounts for almost half of total public sector employment, with around one-quarter of employees working in the NHS and just under one-quarter in education. These last two areas have been treated relatively favourably in the public spending round, but cuts in employment in both areas are still expected. Bigger cuts will, inevitably, occur in other areas.

**Table 3.3**  
Structure of public sector employment in the UK, Q4 2010

	Headcount ('000s)	% of total headcount
Central government	2,809	45
Local government	2,863	46
Public corporations	523	8
NHS	1,601	26
Education	1,620	26
Public administration	1,200	19
Other	1,780	29
<b>Total</b>	<b>6,195</b>	-

Source: ONS, Public Sector Employment

Note: Public corporations include employment in state-owned or part state-owned financial institutions

The latest forecast from the OBR shows a fall in general government employment of around 400,000 over the next five years.

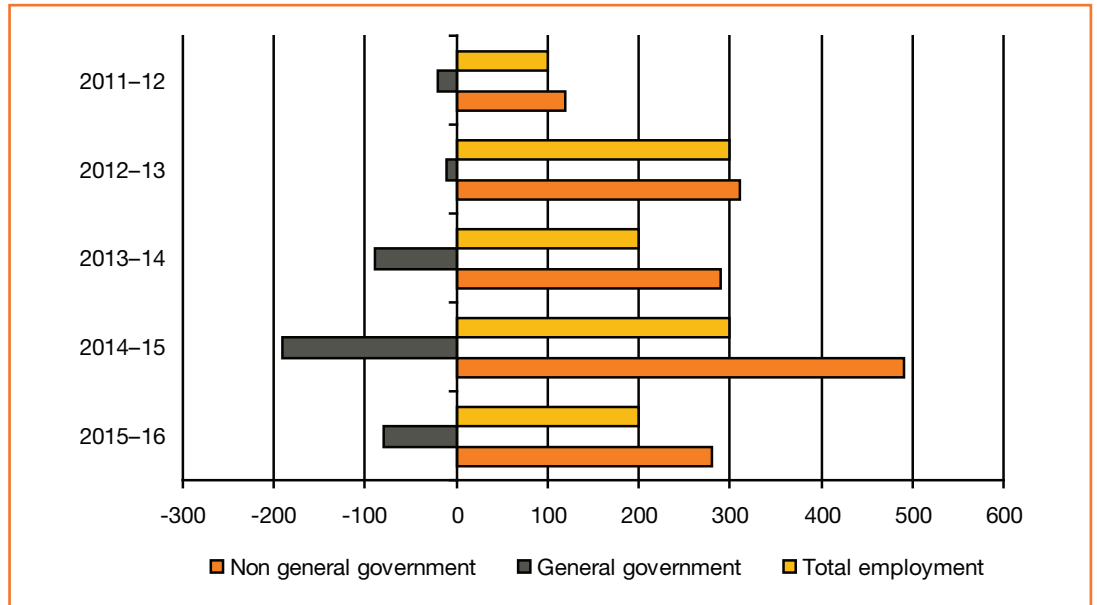
**Table 3.4**  
General government employment ('000s, final quarter of financial year)

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Employment	5,670	5,650	5,640	5,550	5,360	5,280
Change		-20	-10	-90	-190	-80

Source: OBR 2011

The OBR is, though, optimistic that the private sector can take up the slack. It believes total employment will increase steadily over the next five years – and by enough after 2011 to allow unemployment to fall. This will require some large increases in employment in the private sector.

**Figure 3.3**  
OBR employment forecasts, change over year to last quarter of financial year ('000s)



Source: OBR 2011

Others take a gloomier view. The Chartered Institute for Personnel Development (CIPD) has predicted, based on 'soundings from public sector managers' that 725,000 jobs will be shed in the public sector between 2009/10 and 2015/16 as a result of spending cuts. They also think that an additional 900,000 jobs will be lost in the private sector as a direct or indirect result of government spending cuts and the increase in the standard rate of VAT to 20 per cent (CIPD 2010). As a result, they expect unemployment in the economy as a whole to increase in 2011 and 2012 and are not particularly optimistic about it falling back to its current level by 2015/16.

PricewaterhouseCoopers (PwC) estimate that the public spending cuts alone will result in one million job losses in the public and private sectors by 2014/15 (roughly half a million in each sector) – equivalent to 3.4 per cent of all jobs (PwC 2010). Regionally, PwC expect the effects of the spending cuts to be spread across the UK, with no region or country experiencing less than a three per cent loss of jobs. But there are places where the impact will be relatively severe, including Northern Ireland, where over five per cent of jobs are expected to be lost, and Scotland, Wales, and the North East, where the figure is over four per cent.

**Table 3.5**  
Estimated public and private sector employment effects of public spending cuts (in 2014/15)

Region	Absolute number of job losses ('000s)	% of total jobs in region
Northern Ireland	36	5.2
Wales	52	4.3
Scotland	95	4.1
North East	43	4.1
North West	108	3.7
Yorks. and Humber	82	3.7
West Midlands	80	3.6
South West	81	3.5
East	74	3.2
East Midlands	58	3.2

London	122	3.1
South East	112	3.1
<b>UK total</b>	<b>943</b>	<b>3.4</b>

Source: PwC 2010

The Centre for Cities has highlighted how certain towns and cities across the UK are likely to be badly affected by job losses in the public sector (2011). Its projections, based on an earlier OBR estimate that 330,000 jobs would be lost by 2014/15, show there are some places where the direct effect of the cuts could be over two per cent of all jobs.

**Table 3.6**  
Estimated public sector  
job losses

City	Job losses	% of all jobs
Newport	2,200	2.9
Swansea	3,000	2.9
Plymouth	2,500	2.4
Liverpool	7,900	2.3
Portsmouth	4,400	2.1
Stoke	3,100	2.1
Sunderland	2,500	2.1
Dundee	1,500	2.1
Middlesbrough	3,700	2.1
Hull	2,300	2.0

Source: Centre for Cities 2011

The outlook for Newport and Swansea is particularly grim because of the presence of the ONS in the former and the Driver and Vehicle Licensing Agency in the latter. The Centre for Cities also points out that there will a large number of job losses in the North East.

In order to calculate the effects by sector, PwC looked at those sectors that will be hit hardest because they are largely funded from public sources and estimated how much spending in each sector would fall. It then estimated for each of these sectors how much their demand for inputs from the rest of the private sector would fall as a consequence of the cuts. Finally, it estimated how much the 30 hardest-hit private sub-sectors would cut their inputs.

**Table 3.7**  
Estimated private sector  
employment losses in  
2014–15 due to reduced  
public sector demand

Sector	% loss of employment	Implied employment reduction ('000s)
Construction	5.1	104
Business services	3.9	186
Manufacturing	2.0	51
Transport and communications	1.9	47
Other sectors	1.5	44
Financial services	1.1	11
Distribution, hotels and catering	0.4	25
<b>Total private sector</b>	<b>2.1</b>	<b>468</b>

Source: PwC 2010

This methodology, which focuses on business supply chains, suggests the construction and business services sectors would be hit the hardest, while distribution, hotels and catering would get off relatively lightly. However, it underestimates the effect on consumer-facing sectors, such as distribution, because it does not take into account the effects of reducing consumer spending as a result of job losses in the public sector.

Whichever forecaster is eventually proved right about the precise numbers, the pattern after the last recession looks set to repeat itself. Between 1992 and 1998 employment in the public sector fell by over 800,000. Initially, private sector employment increased only slowly, so total employment fell. Only from 1994 onwards did employment in the private sector grow fast enough to offset the decline in the public sector. A similar pattern is likely to occur over the next five years.

This could have a considerable impact on female employment. Almost 65 per cent of employees in the public sector in Great Britain are female (compared to 40 per cent in the private sector).<sup>16</sup> The public sector is particularly important for women’s employment because it provides relatively high-quality part-time employment, which is often required by working mothers. The proportion of women working part-time is roughly the same in the public and private sectors, at 41 and 43 per cent respectively, compared to 13 and 12 per cent of male workers.

However, the wages of part-time women are substantially higher in the public sector compared to their counterparts in the private sector, more so than for full-time men or women. The public sector wage premium for part-time workers also rises further up the earnings distribution, whereas among full-time workers, it is stronger for lower earners. The higher wages enjoyed by part-time workers in the public sector (of whom 85 per cent are women) is in part due to the greater number of part-time jobs at higher occupational levels.<sup>17</sup> The risk is that part-time working women displaced from the public sector will struggle to find to part-time private sector employment with comparable wages and skill requirements. For some women, this will necessitate occupational downgrading but others may decide to leave the labour market to avoid this.

**Table 3.8**  
Public sector earnings relative to private sector earnings, by gender and working patterns, 2010

	Public sector wage premium		
	25th earnings percentile	Median earnings	75th earnings percentile
Full-time men	20%	17%	8%
Full-time women	31%	36%	25%
Part-time men	43%	52%	87%
Part-time women	43%	52%	61%

Source: Authors’ calculations using Annual Survey of Hours and Earnings. <http://www.statistics.gov.uk/statbase/Product.asp?vlnk=1951>.

Some economists believe the UK’s dependence on the public sector for employment is even greater than shown in the official numbers – and by implication that the outlook for employment in coming years is gloomier than mainstream forecasts suggest.

Buchanan et al (2009) define public sector employment as state employees plus ‘para-state employees’. State employees are those directly employed by the state; para-state employees are those working in the private sector but still reliant on the state for their job, such as, for example, construction workers building new roads or rubbish collectors working for a private company that has a contract with a local authority. Such calculations are not without their problems. The data do not allow para-state employees to be identified directly, so assumptions have to be made, for example, about the number of construction workers whose jobs are dependent on state funding. But this way of looking at the labour market gives a different and interesting insight to the published data.

Their calculations suggest that more than half of job creation in the UK over the period from 1998 to 2007 took place in the state and para-state and that in some regions – the North East, Yorkshire and Humberside, and Scotland – the proportion was considerably higher. The most striking result, though, is for the West Midlands, where private sector

<sup>16</sup> Annual Population Survey, accessed through Nomis

<sup>17</sup> Wages are generally higher in the public sector, in part because the workforce is older, has higher level skills and works in higher level occupations. However, Damant and Jenkins (2011) found that the wages of public sector workers were 7.8% higher in 2010 than their private sector counterparts after controlling for gender, age, occupation, region and qualification.



employment contracted, and the increase in state and para-state employment was larger than the overall rise in employment. Only in London, the South East and the South West did the private sector account for more than half of all job creation in this period.

**Table 3.9**  
Private and public sector  
employment

	Change in employment, 1998–2007 ('000s)			Share of employment in state and para-state, 2007 (%)
	Private sector	State and para-state	Total	
North East	18	66	84	33.1
North West	107	142	250	28.7
Yorks. and Humber	61	130	190	29.5
East Midlands	72	88	161	27.4
West Midlands	-37	105	68	27.5
East	79	111	190	26.9
London	194	120	315	23.0
South East	171	136	307	26.6
South West	161	125	286	29.7
Scotland	77	168	246	32.1
Wales	67	82	149	34.3
<b>Total</b>	<b>972</b>	<b>1,273</b>	<b>2,244</b>	<b>28.1</b>

Source: Buchanan et al 2009

The final column of table 3.9 shows that, in 2007, Wales, the North East and Scotland were most dependent on the government for employment. Scotland (28 per cent) and Wales (25 per cent) also experienced the largest percentage increases in employment reliant on government support between 1998 and 2007.

Buchanan et al argue that dependency on the public sector was even greater than these numbers imply. They note that, over this period, some private sector jobs, for example in the retail sector, will only have been created because of the extra spending of those employed by the state and para-state. They conclude that outside London and the South, over the nine years to 2007, there was ‘... at best modest autonomous private sector job creation, and at worst no autonomous private sector job creation ...’ (ibid: 23).

Indeed, they argue that ‘the UK has an undisclosed business model of using publicly supported employment to cover the continuing failure of the private sector to generate and distribute welfare through job creation’ (ibid: 2). They are clear that it is weak growth in employment that has necessitated the public sector to step in: ‘[T]he employment outcome of the 1990s and 2000s is in line with pre-1979 trends. The difference is that authors ... could then argue that the expansion of state employment was “crowding out” but it now looks more like filling in’ (ibid: 20–21).

If this is right, it has profound implications for the future. The Coalition government’s programme of deficit reduction and public spending cuts represents an abandonment of this model. Publicly supported employment is sure to fall over the next few years. The government’s hope is that the private sector will take up the slack – and more – to allow unemployment to come down. If, however, Buchanan et al are right in suggesting there are long-standing structural reasons for the failure of the private sector to create jobs, these hopes may prove to be misplaced.

### Social care

Despite considerable reductions in public sector employment overall, there are opportunities for employment growth in the social care sector as a result of the rapidly ageing population. Social care is already a major employer in the UK, providing over 1.5 million jobs, 71 per cent of which are in the direct provision of care (HM Treasury and

BIS 2011). Employment is primarily located within private and charitable providers, with services commissioned but not necessarily delivered by local authorities.

Approximately 80 per cent of social care workers are female, and 4.3 per cent of direct care workers are on temporary contracts.<sup>18</sup> The sector is relatively heavily reliant on migrant workers: in England, 31 per cent of the workforce were born overseas, rising to half of all workers in professional social care occupations (such as qualified nurses). In London, two thirds of the workforce is foreign-born, rising to 82 per cent for those in professional roles and 70 per cent of care workers.

Vacancy rates in the sector are relatively high, with 3.1 per cent of positions being unfilled within a three-month period – over twice the average vacancy rate across all sectors. The long-term trend is for vacancy rates in the sector to rise (Skills for Care 2010). Turnover rates are also high compared to other industries.

The reliance on migrant and temporary workers combined with high vacancy and turnover rates indicates that the sector is not perceived as a particularly attractive source of employment among UK nationals. Social care is known to be relatively low paid and workers tend to have low levels of qualifications, with the exception of those with professional medical and care qualifications. The market is highly fragmented and reliant on public funding, which can put pressure on quality, training and career progression routes (Bradley 2011).

Projections suggest that the social care workforce will have to expand by between 50 and 80 per cent by 2025 in order to meet growing needs. This would require between 638,000 and one million extra recruits in direct care roles alone (Skills for Care 2009). The size of the existing workforce combined with increasing long-term demand and rising vacancy rates indicates that the social care sector will be a source of employment growth across the UK.

The relatively low entry requirements of many jobs in the sector mean that it could offer strong employment prospects for people who lack high-level qualifications. The challenge will be raising the attractiveness of the sector among UK residents, which will require considerable improvements in pay, working conditions and progression routes. Meeting the expanding demand for social care will also require a sustainable settlement on funding for long-term care, as recently considered by the Dilnot Commission on Funding for Care and Support.

### **Real estate and construction**

One of the most significant features of the UK economy in the 2000s was the boom in the housing market. House prices increased at an annual rate of 13.5 per cent between the start of the decade and the end of 2007 according to the Nationwide Building Society.<sup>19</sup> This was accompanied by strong growth in employment in the real estate sector, where 188,000 extra jobs were created between 1998 and 2008 – a more than 70 per cent increase, and the largest percentage increase in employment in any broad sector of the economy over this period.

Surprisingly, despite the subsequent fall in house prices and collapse in activity in the housing market (approvals for mortgages for house purchase were down from 120,000 a month at the beginning of 2007 to 47,000 in February 2011),<sup>20</sup> employment in the real estate sector has increased further – albeit only by 8,000 – since the recession began. Any sector bucking the trend to lower employment is welcome but this appears to be inconsistent with the government's desire to rebalance the economy away from its past dependence on ever-higher levels of consumer debt – often secured on housing assets – towards other sources of growth. If this rebalancing is successful, employment in real estate may not increase significantly in coming years.

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18 NMDS-SC Online Statistics: <http://www.nmds-sc-online.org.uk/research/researchdocs.aspx?id=9>

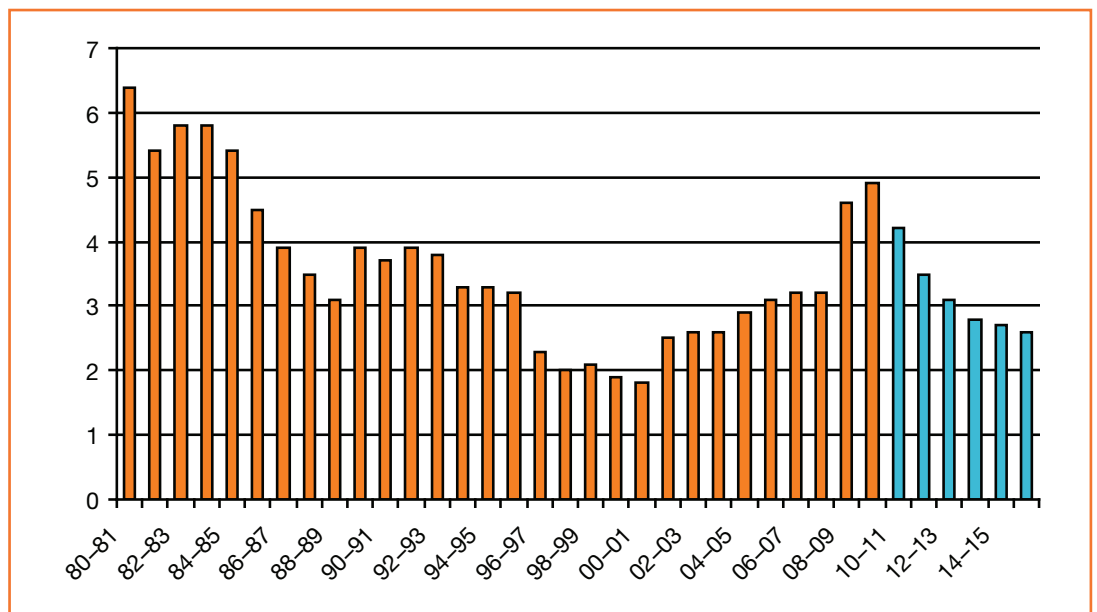
19 Nationwide Building Society, House Prices Index: <http://www.nationwide.co.uk/hpi/>

20 Bank of England: <http://www.bankofengland.co.uk/publications/other/monetary/LendingToUKBusinessesandIndividualsApril2011.xls>

The boom in house prices over the decade to 2008 was accompanied in its later years by increased housing construction. The number of dwellings completed in the UK rose from 178,000 in 1998/99 to a peak of 219,000 in 2006/07 – an increase of 23 per cent.<sup>21</sup> Employment in the construction industry also increased by 23 per cent (or by 434,000) between the second quarters of 1998 and 2008. This was not just the result of more house building. In part, it was also due to a marked shift in the pattern of government spending after 2000. In the early part of the recovery from the 1990/91 recession, public sector investment spending was cut as the government sought to reduce its annual borrowing requirement. The Labour government elected in 1997 made further cuts to investment as part of its commitment to stick to the previous government’s spending plans. However, after the 2001 general election there were substantial increases in investment spending as the government embarked on a programme of building and refurbishing schools and hospitals.

The recession has already seen a sharp reversal of fortune for the construction sector, with employment down by 176,000, or eight per cent, since the second quarter of 2008 and the outlook is gloomy. It is widely acknowledged that an increased rate of home building is needed in the UK (see for example Schmuecker 2011) but most industry analysts believe outcomes will fall short of demand. Meanwhile, as part of its deficit reduction programme, the government is planning significant cuts in public sector investment spending.

**Figure 3.4**  
UK public sector gross investment spending, percentage of GDP



Source: OBR<sup>22</sup>

Construction tends to be a ‘late cycle’ sector – that is it performs best after other parts of the economy have already been recovering from recession for a number of years. This seems very likely to be the case in the present recovery. As a result, there is little likelihood of any significant increase in employment in the sector over the next few years, though prospects could improve in the second half of the decade. The chances of such an outcome would be increased if policies could be devised to boost the rate of house building in the UK – a move that is necessary in any case to narrow the gap between the demand for and the supply of housing (Schmuecker 2011).

### Finance

There have been many calls since the financial collapse began for a ‘rebalancing’ of the UK economy. Generally, these are calls for less emphasis on the financial sector and more on manufacturing. For example, at the Labour party conference in 2009 Lord Mandelson,

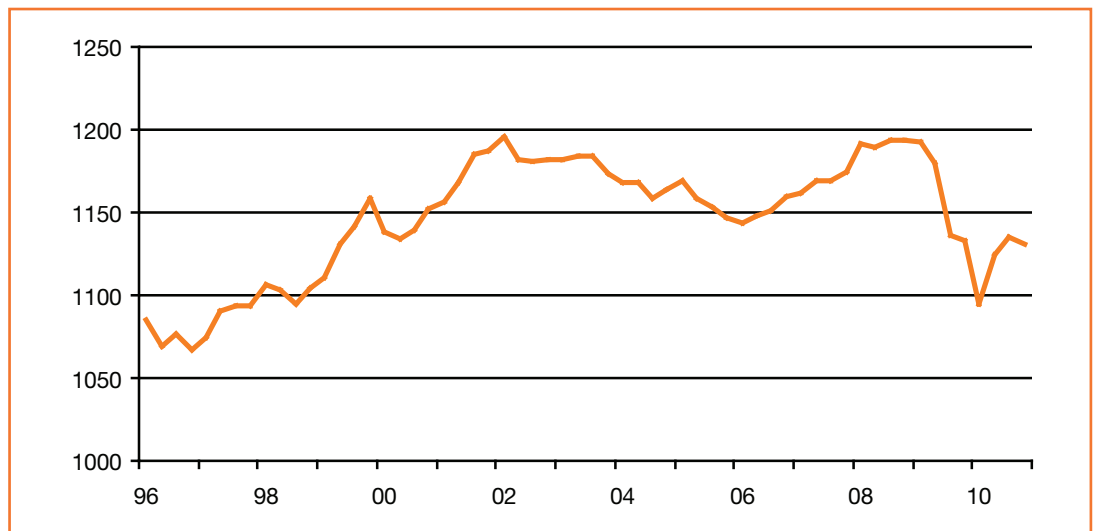
21 Office for National Statistics: HouseBuilding: December Quarter 2010, England. <http://www.communities.gov.uk/documents/statistics/pdf/1845606.jpg>

22 March 2011 economic and fiscal outlook supplementary fiscal tables. [http://cdn.budgetresponsibility.independent.gov.uk/obr\\_fiscal\\_supplementary\\_tables.xls](http://cdn.budgetresponsibility.independent.gov.uk/obr_fiscal_supplementary_tables.xls)

then business secretary, said the economy needed ‘less financial engineering and more real engineering’.<sup>23</sup> Rebalancing of the economy is now Coalition policy. However, an examination of trends in the labour market suggests this focus could be misplaced for two reasons. First, the financial sector was never a source of much employment growth, even in the boom years. Second, the decline in manufacturing employment is so well established that it is unlikely to be reversed, except perhaps on a temporary basis.

Take the financial sector first. Employment in financial and insurance activities increased by just five per cent between 1992 and 2008 (overall employment increased by 16 per cent over the same period); it has subsequently fallen by six per cent. As a result there are now 19,000 fewer people working in the sector than there were 18 years ago. While financial firms were growing rapidly and taking on more highly paid specialist staff – bond traders, investment analysts, hedge fund managers and the like – they were also reducing employment in their ‘back offices’. Some jobs transferred overseas, but many more disappeared as a result of technological change. Numerous clerical and secretarial jobs in the financial services industry no longer exist because records are computerised, and the increased use of credit and debit cards means bank branches require fewer staff. The effects have been largest in the insurance, reinsurance and pension funding sub-sector, where employment more than halved from 226,000 in 1998 to 91,000 in 2010.

**Figure 3.5**  
Employment in financial services, UK ('000s)



Source: ONS, Labour Force Survey

Official data show the number of people working for financial service businesses, not the total number reliant on the financial sector for employment. The latter would also include lawyers, consultants and computer programmers from outside the industry, who are classified under the catch-all heading of ‘other business services’. It is possible that these jobs have increased significantly over the last 15 years as a result of the expansion of financial activity in the economy, but unfortunately the data do not tell us.<sup>24</sup>

Estimates of financial services employment in London show a similar pattern. Since 2000 there has been a small decline in employment in the City of London, offset by a larger increase in employment in Canary Wharf, but overall the number of ‘City-type’ jobs has not increased.

<sup>23</sup> <http://www.labour.org.uk/peter-mandelson-speech-conference>

<sup>24</sup> Of course, even if the data did reveal the extent of such extra employment, linking jobs in one sector to activity in another can be taken to extremes. There would be fewer workers in the electricity industry if there was no financial sector. But there would be fewer workers in financial services if people in the electricity industry did not save into pensions. Ultimately, everything depends on everything else.

**Table 3.10**  
Financial services  
employment ('000s)

	City of London		Canary Wharf		London 'City-type'
	Financial	Total	Financial	Total	
2000	158	330	11	46	325
2001	134	309	24	62	312
2002	143	312	22	57	305
2003	145	311	26	61	317
2004	125	290	40	78	316
2005	135	306	47	87	327
2006	131	303	54	96	342
2007	135	312	57	105	353
2008	140	312	60	108	324
2009	-	-	-	-	305

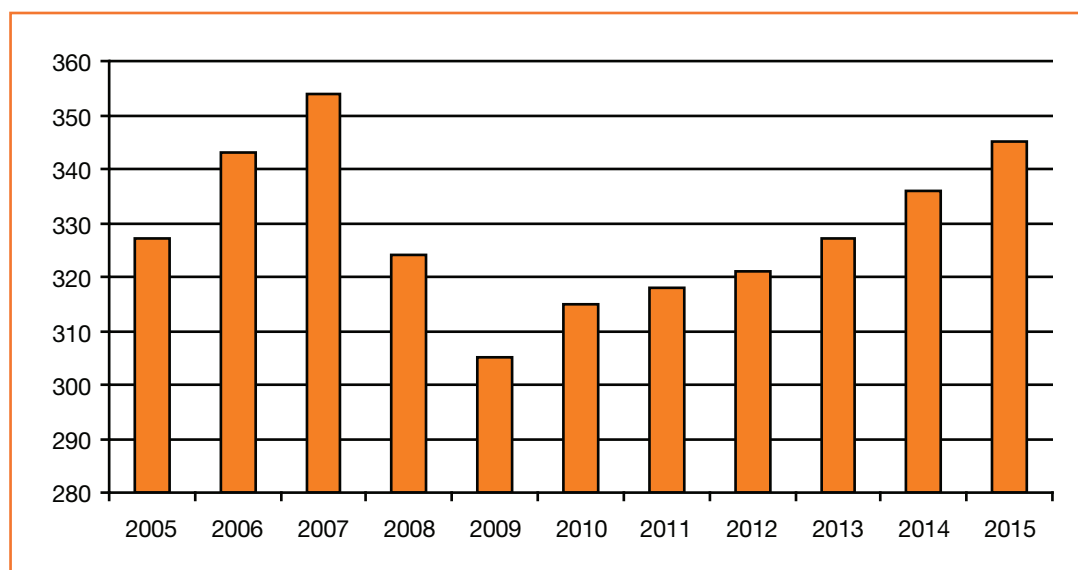
Source: The CityUK 2010

It is difficult to assess how far these trends might continue. Employment in financial services did increase in 2006 and 2007 in the run up to the financial collapse. This may be a sign that back-office rationalisation was largely complete by then – or it may just reflect the extent of the financial boom.

The chances are, however, that the outlook for employment across financial services industries is not good. Banks are looking to increase their capital bases, have agreed to step up lending to small and medium-sized enterprises and are under pressure to rebuild profit margins. Cost control – and keeping employment levels down – will be paramount for several years.

The Centre for Economics and Business Research (cebr) produces regular forecasts of the outlook for 'City jobs'.<sup>25</sup> In its latest forecasts, published in October 2010, it revised down its estimate of the number of City jobs in 2011, from 327,000 to 318,000 – some 10 per cent below the peak level of 354,000 seen in 2007. By 2015, the cebr thinks the number of City jobs will still be a little below this peak level.

**Figure 3.6**  
City jobs forecast, year  
average ('000s)



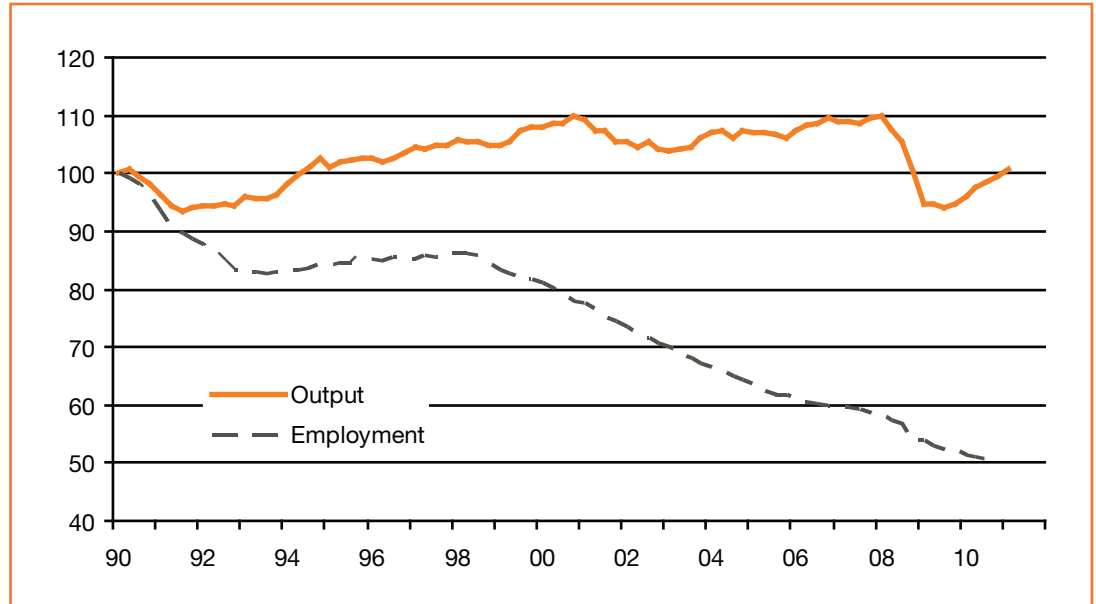
Source: cebr 2010

<sup>25</sup> Securities dealing, international banking, corporate finance, derivatives and foreign exchange activity, fund management (including hedge funds), specialist insurance and professional services such as legal, accountancy and consultancy directly supporting other city jobs – covering jobs in Canary Wharf, the West End and the Square Mile.

## Manufacturing

At first glance, the outlook for employment in the manufacturing sector is even worse than in finance. Manufacturing in the UK has been in structural decline for some time. Over the last 40 years, while real GDP increased at an annual rate of 2.2 per cent, manufacturing output grew by just 0.3 per cent a year. More recently, between 2000 and 2007, when the rest of the economy was performing strongly, manufacturing output did not increase at all. The consequence has been job losses on a massive scale in the sector.

**Figure 3.7**  
UK manufacturing output  
and employment (index  
1990 Q1 = 100)



Source: ONS, Industrial Output and Labour Force Survey

This almost certainly exaggerates the true underlying picture, in part because the definition of what comprises manufacturing activity and employment has shifted over time. There has been a growing trend to outsource functions such as support services and catering and this has blurred the boundary between manufacturing and services. When a manufacturer employs canteen workers, they are classified as working in the manufacturing sector; when the manufacturer uses an external catering company to provide meals, the canteen workers become part of the service sector.

Nevertheless, there is little doubt that employment in manufacturing in the UK is in structural decline – and that the pace of decline stepped up around 1999. Since the beginning of that year, employment in manufacturing has been falling at an annual rate of over four per cent, with a slightly slower pace of decline in 2006 and 2007 offset by a faster pace during the recession. Moreover, despite a strong resurgence in manufacturing output over the last year and a half (its annual growth rates in the last three quarters were the highest since 1994), employment in the sector is still falling. The corollary of these trends is that there has been very rapid productivity growth in manufacturing over the last 12 years.

There are three factors behind this strong productivity growth in manufacturing. First, global competition – in particular the increasing presence of emerging economies in world markets – has forced companies to boost productivity in order to preserve their profit margins, and to stay in business. Bloom et al (2010) argue that 15 per cent of technical change in Europe can be attributed directly to competition from Chinese imports. Second, rapid technological progress has facilitated this process by enabling companies to substitute machines for workers. Third, those companies that have failed to meet these challenges and have closed will tend to have been companies with below average levels of productivity. Removing them from the data raises the average level of productivity amongst the companies that survived.

Unsurprisingly, given the scale of the overall fall in employment, there have been declines across all sub-sectors of manufacturing industry (with the sole exception of 'other transport equipment'). In terms of absolute numbers, the biggest falls were in areas such

as machinery, computer and electrical products and motor vehicles. In percentage terms, most jobs have been lost in three related sectors: textiles, wearing apparel and leather products. There are now only 86,000 people working in these industries across the whole of Great Britain. The key point, though, is that there are no areas within manufacturing industry that could be identified as pockets of strength for employment.

**Table 3.11**  
Changes in  
employment by  
manufacturing industry,  
Q4 1998 – Q4 2010

Manufacturing industry	Employment ('000s)		Change
	Q4 1998	Q4 2010	
Meat products	185	133	-52
Grain mill, bakery and other food products	232	183	-49
Prepared animal feeds	15	13	-2
Beverages and tobacco	53	39	-14
Textiles	144	56	-88
Wearing apparel	151	24	-127
Leather and related products	29	6	-23
Wood and wood and cork products	79	59	-20
Paper and paper products	100	48	-52
Printing and reproduction of recorded media	212	118	-94
Coke and refined petroleum products	10	8	-2
Chemicals and chemical products	176	95	-81
Basic pharmaceutical products	72	29	-43
Rubber and plastic products	247	162	-85
Other non-metallic mineral products	137	92	-45
Basic metals	143	63	-80
Fabricated metal products	405	298	-107
Computer, electronic and optical products	241	115	-126
Electrical equipment	151	64	-87
Machinery and equip. not classified elsewhere	304	147	-157
Motor vehicles, trailers and semi-trailers	247	129	-118
Other transport equipment	121	122	1
Furniture	114	82	-32
Other manufacturing	113	94	-19
Repair and installation	152	92	-60

Source: ONS, Nomis database

There is, perhaps, one reason for a little optimism: the more than 20 per cent fall in sterling's value on the foreign exchanges since the middle of 2007 (all of which happened in the second half of 2007 and in 2008). This is larger than the fall that occurred after sterling left the European exchange rate mechanism in September 1992. After that fall – and once demand in the European economy picked up – UK manufacturing enjoyed, by its own standards, a relatively healthy period of expanding output and employment in the mid-1990s. If sterling remains around current levels and demand in Europe, and in the euro-area in particular, grows at a reasonable rate, UK manufacturing might experience another purple patch in the next few years.

Recent trade data support this optimism. Export volumes (excluding oil and erratic items) in the first quarter of 2011 were 19 per cent higher than a year earlier. This is even stronger than the export growth recorded in the mid-1990s.

The EEF's latest assessment of the outlook for the UK's manufacturing industry – based on forecasts produced by Oxford Economics – is reasonably upbeat (EEF 2011). It

suggests that manufacturing output, having increased by 3.8 per cent in 2010, will expand by 3.5 per cent in 2011 and a further 3.0 per cent in 2012, so outperforming growth in the rest of the economy for three straight years. It notes that the recovery from recession has been broad-based across virtually all manufacturing sub-sectors and argues that this makes the sector more resilient.

It does, though, note that there are risks, particularly due to the government's spending cuts. Close to one in five companies fear that the cuts will lead to a direct loss of orders, and a further two in five believe that they will suffer as a result of cuts further up their supply chains. And the EEF forecasts also contain bad news for those hoping for a revival in employment in the manufacturing sector. Despite output being projected to grow faster over the period 2010 to 2012 than in any other three-year period since the late 1980s, employment is expected to contract. After a four per cent fall in 2010, Oxford Economics expects further drops of 1.5 per cent in 2011 and 1.0 per cent in 2012. Productivity growth in the sector is expected to remain high. This is, potentially, good news for those working in the industry because they should experience high real wage growth as a result. However, the corollary is likely to be little to no growth in employment in the sector.

The latest figures show there are 2.5 million people still classified as working in manufacturing. In the absence of government policies designed specifically to boost the role of manufacturing in the economy, the most likely outcome appears to be that this number will fall less rapidly over the next five years or so than in the recent past. Employment in manufacturing could be about 2.25 million – or 250,000 less than it is today – by the middle of the decade. The worst case would be an extension of the trend of the last decade, in which case manufacturing employment could be below two million by the end of 2015, but only the most optimistic of forecasters would foresee a scenario in which there is an increase in manufacturing employment in the UK.

For much of the 2000s, while other parts of the labour market were strong, policymakers were able to turn a blind eye to developments in the manufacturing sector. In coming years, policies will need to be developed to promote growth – and employment – in the sector. It will also be necessary to support people who lose their jobs in manufacturing, and are unable to find replacement jobs in the sector, to transition into work in other sectors. Retraining will be an essential part of this process.

Not only is the desire to see an expanding manufacturing sector in the UK probably futile, it may also be misplaced from an economic efficiency point of view. It is wrong to look back to an era when Britain 'made real things' and sold them to the rest of the world and to imagine that those times can be recreated. The world has moved on. Emerging economies with low labour costs now have the comparative advantage when it comes to manufacturing a broad range of goods. Developed economies, such as the UK, have their comparative advantage in services. In 2010, the UK had a trade deficit of £98 billion in goods and a trade surplus of £51 billion in services. If the overall trade gap is going to be closed, without a serious recession that leads to a collapse in imports, it is most likely to be through stronger exports of services.

### **Retail and associated sectors**

There is a widespread consensus that the UK economy should be rebalanced away from its reliance in the last recovery on debt-fuelled consumer spending and towards exports and business investment. Consumer spending increased at an annual rate of 3.4 per cent over the ten years to 2007, faster than the rate of GDP growth, which was 2.9 per cent. Meanwhile, imports increased by 6.0 per cent a year and exports by just 4.3 per cent. The trade deficit soared to £43 billion (3.1 per cent of GDP) in 2007 and household debt was 166 per cent of disposable income, up from 100 per cent in 1997 and higher than in any other developed economy.

Although the OBR is forecasting a further increase in household debt over the next five years, it thinks growth in consumer spending will be lower than real GDP growth over this period. Over the five years to 2015, it expects real GDP to increase at an annual rate of 2.6 per cent, while consumer spending goes up by just 1.6 per cent – almost two percentage



points slower than in the decade to 2007. Such a slowdown is sure to have implications for employment in the retail sector and other sectors associated with consumer spending.

Over the decade to 2007, although consumer spending growth was significantly stronger than growth in the aggregate economy, employment in the wholesale and retail sectors increased less rapidly than in the economy as a whole – by 0.4 per cent a year, compared to 1.1 per cent. This suggests productivity gains in wholesaling and retailing were greater than in the overall economy, most probably reflecting wholesalers' and retailers' ability to take advantage of technological change.

It is impossible to be sure that wholesalers and retailers will continue to enjoy such an advantage in productivity growth – but the presumption is that they will. If so, and if the OBR's forecasts are broadly correct, then there is little prospect of growth in employment in these sectors. Indeed, employment might actually fall. This matters because together they employ almost five million people.

Employment in other sectors is also likely to be affected by slower growth in consumer spending. The accommodation and food services sectors, which now employ almost two million people, had an increase in employment of 1.4 per cent a year in the decade to 2007. Tougher times for households will probably mean less spending growth in these sectors – and thus less employment growth.

Taken together sectors directly related to consumer spending employed close to nine million people in 2007 – an increase of over 700,000 on 10 years earlier. It is likely that jobs in these areas will increase at a much slower pace in next five years.

### **Professional, business and scientific services**

This is a large and amorphous sector covering a range of services, including legal services, accountancy and architectural services, management consultancy, advertising, and research and development. It is a key sector for the UK in terms of employment, gross value-added (GVA) and exports. The sector has the largest GVA in the UK, and accounted for a third of GVA growth between 2000 and 2007 (HM Treasury and BIS 2011). Many parts of the sector are internationally renowned and highly competitive, with the UK being the largest net exporter of business services in the G7 (ibid).

Demand for professional and business services is expected to increase nationally and internationally in coming years as the drivers that have seen the sector grow substantially over the last two decades are expected to continue. These include the continued outsourcing of a range of business support functions within both the public and private sectors, and global economic integration. There is growing competition from the emerging economies but the skill base and experience of UK firms in this sector is considerably advanced, and they are likely to continue to compete internationally through continued skill development and innovation.

The sector is centred on London and the South East, but is also important in a number of regional cities. Given the professional nature of many of the services, the sector is unsurprisingly a highly qualified one, offering good prospects for high-skill employment growth. However, it is unlikely to offer immediate employment opportunities for people with limited employment experience or skills, such as many of the long-term unemployed. It is likely to provide better prospects for people with higher level qualifications who became unemployed in the recession, including public sector professionals with generic and transferable skills and experience.

### **Information, communication and creative industries**

The UK has a strong competitive advantage in a number of information, communication and creative industries. The sector is the third largest exporter, after advanced manufacturing and professional services (ibid). Total employment in the creative industries was estimated at 1.3 million in 2010, with a further one million creative jobs identified in sectors outside the creative industries (Department for Culture, Media and Sport 2010). Software development, computer gaming and electronic publishing are particularly important sub-sectors for the UK, employing 600,000 people in 2010 (Scheffel and Thomas 2011).

The sector appears to offer relatively good prospects for employment growth in the medium term. Employment in the sector is predicted to grow by around 450,000 by 2014, even after the impact of the recession is taken into account (Reid et al 2010). However, the sector is relatively volatile in employment terms on a year-to-year basis, and employment growth is driven by a small number of sub-sectors, primarily software and electronic publishing (ibid).

Information, communication and creative industries have a similar profile to business services in that they tend to attract highly qualified employees, primarily graduates, and rely on high-level skill development and utilisation and rapid innovation to stay competitive. Jobs in the sector are also relatively concentrated in London and the South East, although there are significant employment clusters in a number of UK cities.

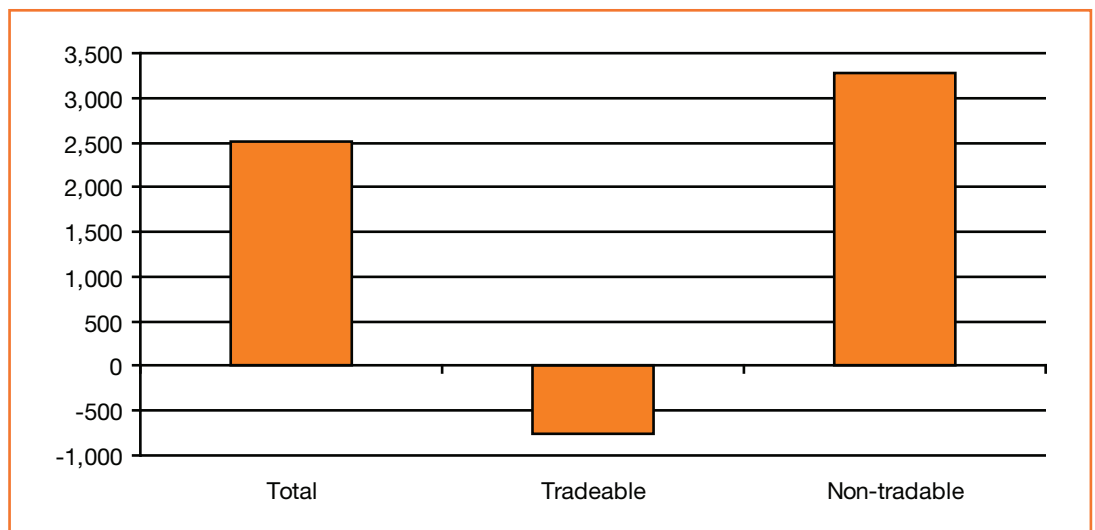
### Tradable and non-tradable goods and services

A useful understanding of developments in the UK labour force can be gained by looking at the distinction between tradable and non-tradable sectors rather than the one between manufacturing and the rest of the economy. The tradable sector comprises industries that produce goods and services that can originate in one country and be sold in another. This includes most manufactured goods and many business services. The non-tradable sector produces goods and services that have to be, or most often are, produced and sold in the same country, such as health care and retailing.

The distinction is not hard and fast. Some industries include tradable and non-tradable elements – for example, a hotel that caters for domestic and overseas visitors. Other industries have evolved over time to become more tradable, not least due to the growth of the internet. This means we can only estimate approximately the number of people working in each sector at any point in time.

Spence and Hlatshwayo (2011) look at the structural evolution of the US economy over the last two decades by classifying different industries as either tradable or non-tradable, or both. They then calculate series for value-added and employment in each sector. We have used a similar methodology, to look at developments in the UK over the last 14 years. The results are striking. From the fourth quarter of 1996 to the fourth quarter of 2010, employment in the UK increased by 2.52 million. But the number of jobs in the tradable sector fell by 0.77 million, while the number of jobs in the non-tradable sector increased by 3.29 million.<sup>26</sup> It is no surprise, therefore, that the UK's overall trade balance – including goods and services – deteriorated significantly over this period (from a surplus equal to 0.1 per cent of GDP in 1996 to a deficit of 3.2 per cent in 2010).

**Figure 3.8**  
Change in employment,  
Q4 1996 – Q4 2010  
('000s)

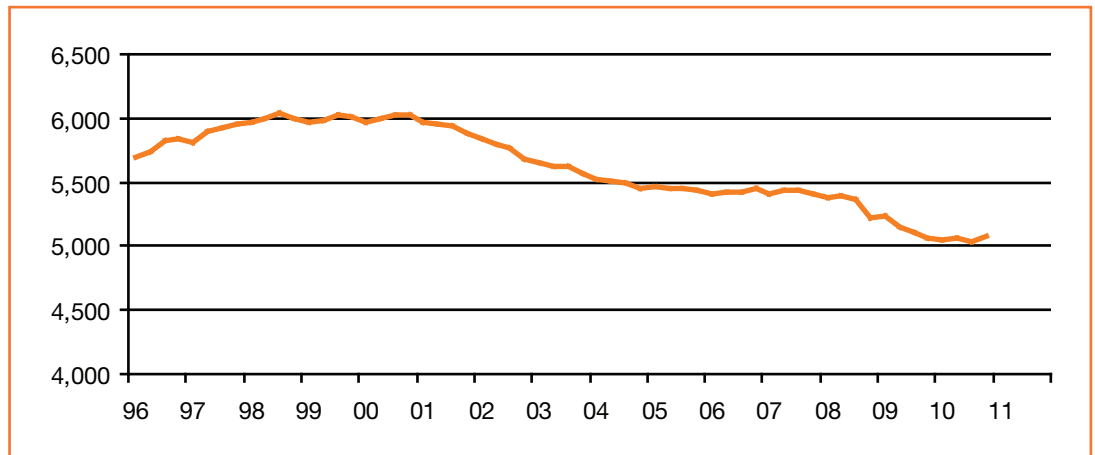


Source: ONS, Labour Force Survey

<sup>26</sup> In comparison, Spence and Hlatshwayo report a negligible increase in US employment in the tradable sector between 1990 and 2008 – all US jobs growth occurred in the non-tradable sector over this period.

The decline in employment in the tradable sector occurred in two phases. Employment fell by around 500,000 during 2001 to 2003 when global growth was weak; and then it fell by a further 300,000 in the recent recession.

**Figure 3.9**  
Employment in tradable sector, UK ('000s)



Source: ONS, Labour Force Survey

The pattern, therefore, is one of the UK maintaining employment in the tradable sector when the world economy – and world trade – are expanding rapidly, but seeing the number of jobs decline whenever growth weakens.

Given the prospective shrinkage in employment in the public sector over the next few years and the need to generate more jobs in the private sector, the advantages of support for growth in the tradable sector are clear. This will necessitate a range of policies across areas such as infrastructure spending, supporting innovation, education, training, and taxation.

### Projections of employment by occupation

The Institute for Employment Research (IER) at the University of Warwick has also projected employment trends to 2017 by occupational categories (Wilson et al 2008). As with their projections by industry, these are largely an extrapolation of past trends but with change generally less rapid than over the decade to 2017 than in the previous 10 years. One exception is that the IER expects a faster pace of decline in employment in administration and secretarial occupations over the next 10 years, compared to the last 10.

**Table 3.12**  
Employment by occupational category in the UK, 1987–2017 ('000s)

Employment level	1987	1997	2007	2017
Managers and senior officials	3,271	3,799	4,828	5,700
Professional occupations	2,517	3,034	4,091	4,733
Assoc. professional and technical	2,860	3,591	4,472	5,126
Administrative and secretarial	4,009	3,927	3,715	3,319
Skilled trades occupations	4,177	3,620	3,404	3,178
Personal service occupations	1,202	1,791	2,482	2,925
Sales and customer service	1,595	2,101	2,418	2,522
Machine and transport operatives	2,954	2,661	2,290	2,173
Elementary occupations	4,058	3,703	3,536	3,507
<b>Total</b>	<b>26,642</b>	<b>28,227</b>	<b>31,234</b>	<b>33,184</b>
<b>Net changes</b>				
Managers and senior officials		528	1,029	872
Professional occupations		518	1,057	643
Assoc. professional and technical		731	881	654
Administrative and secretarial		-82	-212	-396

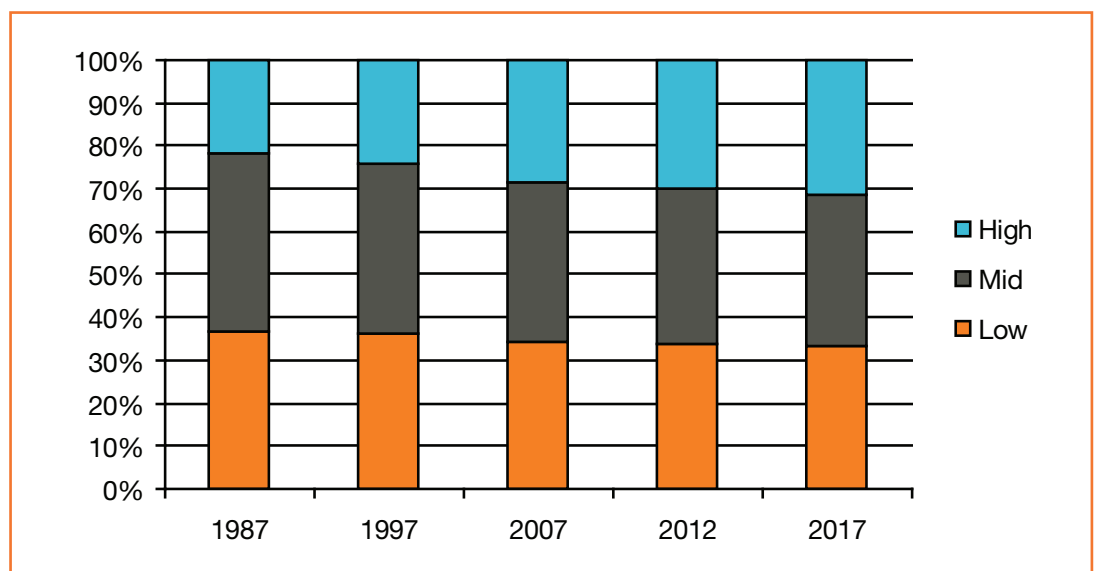
Skilled trades occupations	-557	-216	-226
Personal service occupations	589	691	443
Sales and customer service	506	317	104
Machine and transport operatives	-293	-371	-117
Elementary occupations	-355	-168	-29
<b>Total</b>	<b>1,585</b>	<b>3,008</b>	<b>1,949</b>

Source: Wilson et al 2008: 51

Combining the IER's projections by industry and occupation shows that they expect large falls in employment in low-skilled and elementary jobs, particularly in agriculture, mining and quarrying, and most parts of manufacturing; and relatively large increases in managerial, professional and associate professional jobs in computing and other business services, and in all types of jobs in hotels and catering, as well as in health and social work.

One implication of the IER's analysis is that the 'semi-polarisation' of the UK workforce will continue over the next six years. While the proportion of jobs in the economy that are low-skilled will be little changed, the proportion of high-skilled jobs will increase at the expense of mid-skilled jobs.

**Figure 3.10**  
UK employment by skill level, (%)



Source: Wilson et al 2008

## Conclusion

Mainstream economic forecasters believe the UK economy will return to full employment only slowly in coming years as it recovers from recession and that the balance of risks is tilted to the downside. Historical analysis suggests recessions that are the result of credit and asset bubbles tend to be followed by sluggish and hesitant recoveries. Positive policies are needed to ensure that the recovery is as job-rich as possible.

A slow recovery is likely to be associated with high levels of long-term unemployment. This increases the risk of hysteresis – a permanent fall in the employment rate. Policies need, therefore, to be designed to ensure that people who have been out of work for some time maintain their contact with the labour market.

Projections of the future industrial structure of the labour market tend to rely heavily on the extension of past trends. More insight can be gained from analysis of key sectors in the economy.

The biggest change over the next decade comes from public sector employment. Having been the main source of new jobs across the economy for the last decade, the public sector is very likely to shrink in coming years. This will affect not only workers employed directly by the state, but also those whose jobs rely on public spending, from cleaners

working in public buildings for private service companies to construction workers building new roads.

Other areas of the economy that are unlikely to see buoyant employment growth include real estate, finance, retailing and – despite talk of rebalancing the economy – manufacturing. What jobs growth does occur, therefore, is likely to be found in non-financial business services and in other parts of the service sector, such as adult social care.

## 4. DISADVANTAGED GROUPS IN THE LABOUR MARKET

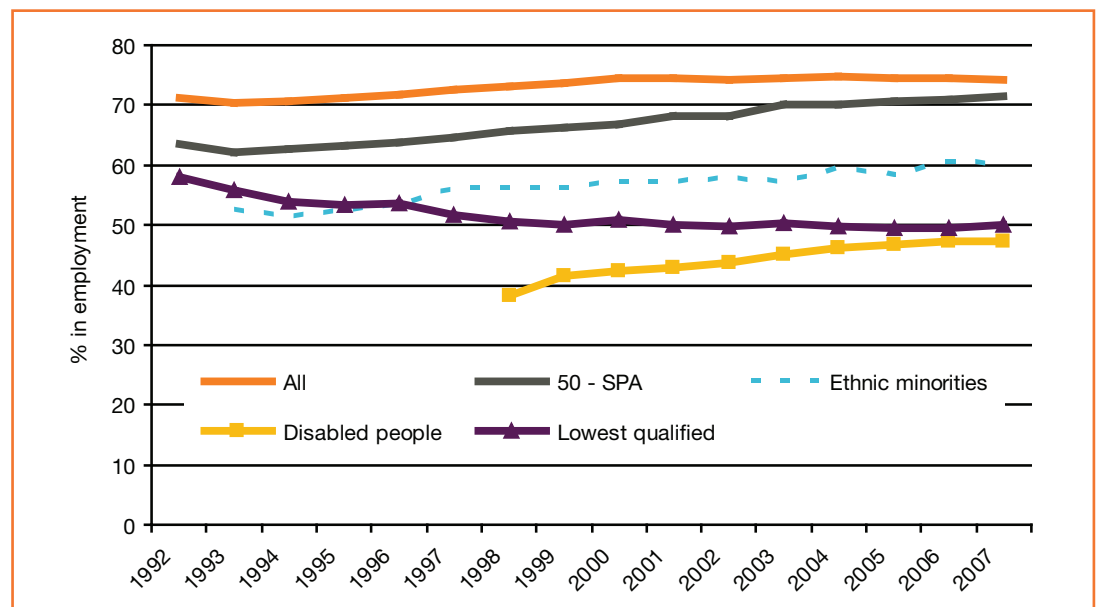
In an environment of high unemployment and slow employment growth, there will be disadvantaged groups that find it particularly difficult to compete in the labour market. Yet even in a buoyant labour market, a significant number of people struggle to find employment. In this chapter, we consider the specific groups of people who tend to have relatively low employment rates and how they might fare as the labour market recovers.

### Age, ethnicity, disability, qualifications

A significant number of working-age adults can be considered to be disadvantaged in the labour market because they have particular characteristics that reduce their attractiveness to employers. This could be because they are perceived to be less productive or more costly to employ than other workers. As a result, these individuals tend to be less likely to be in employment or to participate in the labour market at all. They are sometimes described as forming a reserve or 'buffer' workforce, increasingly drawn on by employers as the pool of 'prime workers' shrinks during extended periods of economic growth; but also the first to fall out of employment during recession (Hogarth et al 2009).

Figure 4.1 shows trends in the employment rate between 1992 and 2007 for some groups of people who could be considered to be disadvantaged in the labour market: older people, ethnic minorities, disabled people and people with no or only low-level qualifications. Over this period of economic growth, the employment rate among most of these groups saw a steady increase, but remained below average.

**Figure 4.1**  
Employment rates for disadvantaged groups (GB), 1992–2007



Source: DWP 2007

Note: Figures are derived from the Labour Force Survey and are for working-age adults aged 16–64 in Great Britain only. SPA = state pension age.

'Disabled' refers only to those who would be considered disabled under the Disability Discrimination Act 1995.

### Older and younger workers

Of the groups shown in figure 4.1, only older workers (those aged between 50 and the state pension age) were approaching the employment rate of the whole working-age population in 2007. In the 15 years prior to the recession, the employment rate for older workers increased from 63.5 per cent to 71.6 per cent, just 2.7 percentage points behind the overall employment rate. Other studies have also found that the employment rate

among people over the state pension age experienced rapid and consistent growth over the decade before the start of the 2008/09 recession (Hogarth et al 2009).

Between 2008 and 2010, employment among older working-age males declined but not as much as for prime age men. The employment rate for men aged 50 to 64 fell by 1.3 percentage points compared to 2.2 percentage points among men aged 25 to 49. The employment rate for men aged 65 and over increased slightly over the same period. Among older women, employment increased slightly among all age groups between 2008 and 2010, compared to a small fall in employment among prime age women (of 0.8 percentage points). These figures indicate that older workers were better protected from the impact of the recession compared to prime age workers.

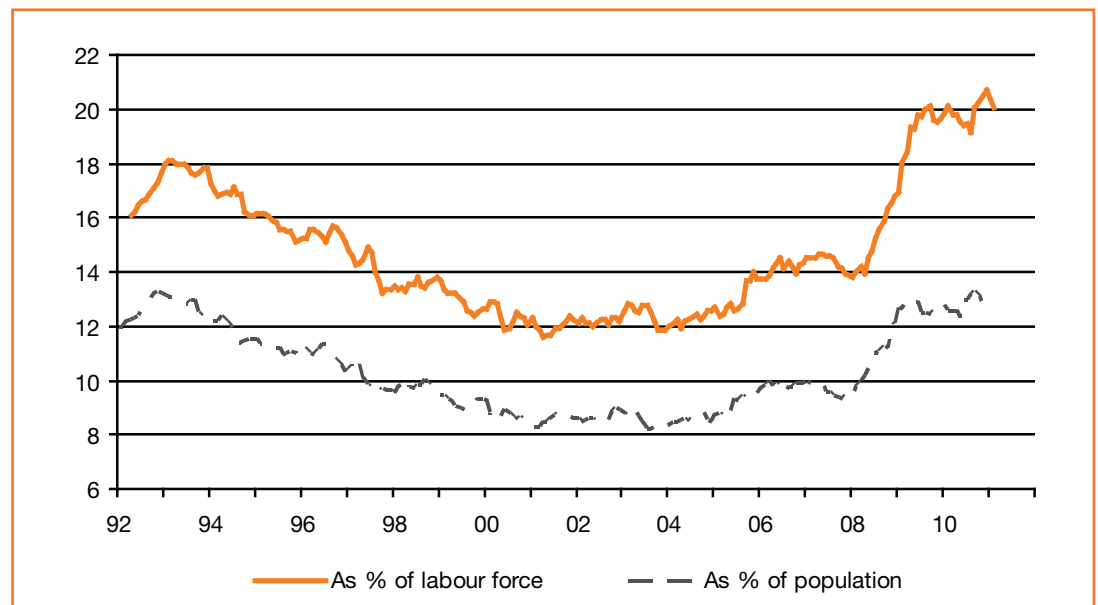
**Table 4.1**  
Employment rate for  
older people, 2008–  
2010, UK

	50–64	All 50+	All 65+
<b>Males</b>			
2008	72.4	45.3	10.2
2009	71.2	44.4	10.5
2010	71.1	44.4	10.9
Change 2008–2010	-1.3	-0.9	+0.7
<b>Females</b>			
2008	57.9	32.2	4.9
2009	58.1	32.5	5.3
2010	58.5	32.9	5.8
Change 2008–2010	+0.6	+0.7	+0.9

Source: Nomis/Labour Force Survey

The youth unemployment rate is higher than in previous recessions, currently standing at 20.2 per cent. This has led to concerns that a generation of young people will be scarred by their initial contact with the labour market and find it difficult throughout life to find stable employment (Bell and Blanchflower 2009). But higher participation rates in further and higher education mean that the youth labour force – the denominator in the calculation – is much smaller than in the past and as a result the high unemployment rate exaggerates the unemployment problem among young people, at least relative to history.

**Figure 4.2**  
Youth unemployment  
rate, 16 to 24 year olds,  
UK (%)



Source: ONS, Labour Force Survey

If youth unemployment is calculated as a proportion of the youth population (rather than as a proportion of the youth labour force), the rate falls to about 13 per cent. This is in line with the level experienced in previous recessions. Youth unemployment is a problem – but it has to be seen alongside other problems in the labour market.

Older people may have fared relatively well in the recession because they are more likely than prime age workers to be in part-time jobs, which continued to grow in number during the recession. Older people also tend to have greater employment protection than younger workers, and therefore are less prone to job loss during recession. This is partly due to formal redundancy rules related to seniority as well as employers often valuing the skills and experience of older workers more highly relative to younger workers.

However, older people who experience job loss tend to find it harder to re-enter employment than younger people. Nearly half (41.5 per cent) of those unemployed over the age of 50 have been seeking work for more than 12 months, compared to just over a quarter (27.4 per cent) of unemployed people aged 18 to 24. Conversely, young people are more likely to lose their job during their recession but tend to be much more successful than older people in regaining employment.

One reason is that, although the skills and experience of older workers tend to be valued more highly by their current employers, they also tend to be undervalued by prospective employers relative to the perceived benefits of younger workers, such as physical health and adaptability (Hogarth et al 2009). Studies of the 1970s and 1980s recessions found that older people tend to look for jobs at a similar level to their previous employment, which is likely to be relatively high, reducing their chances of finding work in the short term (Disney 1999). Returns to training investments tend to diminish with age, making it harder for older people to regain employment in sectors associated with technological change or high training requirements (Stafford and Duffy 2009). Employment practices and benefit rules can also sometimes encourage older workers to drop out of the labour market, for example, by taking early retirement, whereas benefit rules in the UK put greater pressure on young people to seek work.

### People with a disability or long-term health condition

Among the groups represented in figure 4.1, disabled people (those who would be considered disabled under the Disability Discrimination Act) had the lowest employment rate in 2007, at 47 per cent. Employment rates vary significantly for people with different levels of disability. Those who have a DDA disability, but one that does not significantly limit their ability to work, have employment rates almost as high as non-disabled people. Yet only a third of people who have both a DDA and work-limiting disability were in employment in 2010. Employment levels among disabled people are particularly important given the number of working-age adults with a disability. Almost eight million working-age adults had a DDA disability in 2010, approximately one-fifth of the working-age population. In the same year, an estimated 4.6 million working-age adults had a DDA disability combined with a work-limiting disability, or 14 per cent of the working-age population.

**Table 4.2**  
Employment rate by  
disability type (UK)

	All DDA	DDA only	Work-limiting only	DDA and work-limiting	Not disabled
2008	48.0	68.2	66.5	33.5	77.7
2009	47.3	67.2	65.2	32.7	75.9
2010	48.3	72.9	63.7	33.0	75.8
Change 2008–2010	+0.3	+4.7	-2.8	-0.5	-1.9

Source: Labour Force Survey data available on Nomis. <https://www.nomisweb.co.uk/Default.asp>

Notes: 'DDA' means that an individual would be considered disabled under the Disability Discrimination Act, which defines a disabled person as 'a person with a physical or mental impairment which has a substantial and long-term adverse effect on his ability to carry out normal day-to-day activities'. The presence of a work-limiting disability is self-reported.



The impact of the 2008/09 recession on disabled people's employment is unclear. Between 2008 and 2010, people reporting only a work-limiting disability (one that would not be recognised under the DDA) experienced a greater fall in employment than the non-disabled population. People with a work-limiting but not DDA disability numbered 856,000 in 2010. Individuals with only a DDA disability (one that was not work-limiting) experienced a rise in employment over the same period. Among disabled people where employment rates were low prior to the recession, there was no significant change in employment rates between 2008 and 2010.

Berthoud (2011) investigated longer term trends in employment among disabled people using data that goes back to 1975. His study found that, controlling for a range of other factors, disabled people were 17 per cent less likely to be in employment in 1975 than a non-disabled person, and that this figure had risen to 28 per cent by 2000 and has not subsequently fallen.

The penalty was particularly high for people who combine disability with low skills, and Berthoud concludes that employers may have become less willing to employ such individuals. However, the rising employment rate among disabled people between 1992 and 2007 combined with a falling employment rate among the low-skilled means the exact cause of employment disadvantage among disabled, low-skilled adults is unclear.

### Ethnic minorities

Among ethnic minorities, 60.1 per cent were in employment in 2007, up from 52.6 per cent in 1993. Across all ethnic groups, the male employment rate has been converging over the last two decades while among women, the employment gap has remained relatively stable (Hogarth et al 2009).

The impact of the 2008/09 recession varies significantly by ethnicity and gender. On the whole, women fared better than men in all ethnic groups except 'mixed'. The employment rate for women from Indian, Pakistani and Bangladeshi backgrounds continued its upward path between 2008 and 2010, although the employment rate of Pakistani and Bangladeshi women remains very low. Overall, there is no sign that people from ethnic minority backgrounds fared particularly badly during the recession compared to white people.

**Table 4.3**  
Employment rate by  
ethnicity and gender,  
2008–2010, UK

	White	Mixed	Indian	Pakistani/ Bangladeshi	Black
<b>Males</b>					
2008	78.9	62.1	78.3	66.9	66.4
2009	76.7	62.1	76.4	65.5	63.7
2010	76.2	66.9	78.5	64.5	64.5
Change 2008–2010	-2.7	+4.8	+0.2	-2.4	-1.9
<b>Females</b>					
2008	68.3	58.3	59.0	25.9	57.6
2009	67.5	57.4	59.7	26.6	54.7
2010	67.0	56.7	61.1	27.4	57.2
Change 2008–2010	-1.3	-1.6	+2.1	+1.5	-0.4

Source: Nomis / Labour Force Survey

Note: Figures are working-age adults (16–64). Confidence intervals are higher for ethnic minorities given smaller sample size so figures should be treated with caution.

Studies of previous recessions have found that employment among black men tends to be particularly sensitive to the business cycle compared to white and Asian men (Hogarth et al 2009). Other studies have also found that in the recessions of the 1970s and 1980s,

employment among ethnic minorities was ‘hyper-cyclical’, since their employment fell and rose faster than the average as the economy entered recession and recovery. However, data from the 1990s recession suggests that employment rates for ethnic minorities fell faster than average but did not rise faster during recovery (EHRC and GEO 2009).

### People with low-level or no qualifications

Among groups included in figure 4.1, only those with the lowest qualifications (defined as the 15 per cent of the adult population with the lowest qualifications – primarily people with no formal qualifications) experienced a fall in their employment rate during the period of economic growth from 1992 to 2007. Employment among this group fell considerably over the period, from 58.0 to 50.1 per cent. This indicates a worsening structural employment penalty for people with no or only low-level qualifications.

**Table 4.4**  
Employment rates by  
highest qualification, UK  
(19–59/64 year olds only)

	No qualifications	GCSE D–G or equivalent (Level 1)	GCSE A–C or equivalent (Level 2)	A-level or equivalent (Level 3)	Degree or equivalent (Level 4)	Masters/ Doctorate (Level 5)
2007	53.4	74.1	78.6	78.0	87.1	89.3
2008	52.5	73.2	77.6	77.3	85.6	87.4
2009	50.0	70.5	74.7	76.1	84.5	87.4
Change 2007–09	-3.4	-3.6	-3.9	-1.2	-2.6	-2.0

Source: UKCES 2011a

Notes: Levels of qualifications are in line with the National Qualification Framework. GCSEs grade D–G or equivalent includes NVQ 1; GCSE grade A–C or equivalent includes NVQ 2; A Level or equivalent includes AS Level, NVQ 3 and BTEC Nationals; degree or equivalent includes NVQ 4, HNC and HND.

Table 4.4 shows that people with no qualifications experienced a considerable fall in employment between 2007 and 2009, and employment among people whose highest qualification was at GCSE level or equivalent also fell by a similar amount. This is partly due to the impact of the recession on elementary occupations, and suggests that the recession led to a speeding up of the underlying trend towards falling employment among people with low-level or no qualifications.

However, employment rates for people with qualifications at level 1 (usually regarded as low-level qualifications) remain substantially higher than for individuals with no qualifications, highlighting the positive employment returns associated with even low-level qualifications. The employment fall experienced by people with intermediate and high-level qualifications (at A-level or equivalent and above) was noticeably smaller than for those with lower-level qualifications. Although the proportion of adults with no qualifications has been falling over the last 30 years, latest figures show that approximately 12 per cent of the working-age population lacked any formal qualifications in 2009 and a further 17 per cent have their highest qualification at level 1 (UKCES 2011a). The continued fall in employment rates among poorly qualified adults combined with their falling share of the workforce shows that employer demand for these workers is falling faster than supply.

Stam and Long (2010) analysed Labour Force Survey data for 2006 to 2009 – a period covering the end of the last recovery and the recession – to discover the factors that make it more or less likely an unemployed person will leave unemployment and find a job. Their conclusion is that a range of factors matter:

- the duration of unemployment – the longer a person is unemployed, the less likely they are to find a job
- gender – men are less likely to find a job than women
- education – the more qualified a person is, the more likely they are to find a job
- age – the older a person is, the less likely they are to find a job
- location – unemployed people in Scotland, the South West and the South East are more likely to leave unemployment.

## Employment change among sub-groups over the next decade

Hogarth et al (2009) produced projections to 2020 for employment among some disadvantaged groups, and for women and men, in early 2009 using 2008 data as the baseline. These projections use the same model constructed for the employment projections discussed in chapter 3. They should be treated with particular caution since projections for sub-groups are difficult to do accurately. The projections also assume the continuation of existing benefit and welfare-to-work policies and do not reflect the full scale of public spending cuts, which were clarified after the projections were completed. Nevertheless, they provide a useful guide to how employment rates for disadvantaged groups may change as the recovery progresses.

### Men and women

The projections show a similar decline in employment for men and women between 2008 and 2013, followed by a higher employment growth rate for men over the period 2013 to 2020. As a result, women's share of employment is predicted to be slightly lower in 2020 than in 1993: 46.5 per cent compared to 47.2 per cent.

The most significant change in employment patterns among men and women is expected to come from changes in part-time work. Men are predicted to more than double their share of part-time work, from eight per cent in 1993 to 16.5 per cent in 2020. The authors suggest this will primarily be the result of men taking jobs in sectors previously considered to be 'female' rather than changes in the hours of jobs that men currently do. The growth rate in full-time employment is expected to be similar for men and women.

There are projected to be particularly steep falls in the number of administrative and elementary jobs done by women and elementary jobs filled by men by 2020. Over the same period, both men and women are expected to see continued strong growth in employment in management and professional jobs; and women are also expected to see strong growth in employment in personal services and sales.

Women are likely to find themselves disproportionately affected by cuts in employment in the public sector – the only broad sector of the economy where there is a clear majority of female workers. In particular, mothers who prefer part-time, flexible jobs will find there are fewer such jobs available than in the past.

### Age

Similar rates of employment growth are predicted across all age groups to 2020, but this will represent a marked slowdown for older workers. This reflects the authors' assumption that older workers were used as a 'reserve workforce' during the 2000s and will experience reduced demand in the 2010s.

Among young people (those aged 18 to 24), there is predicted to be continued substantial decline in employment in elementary occupations to 2020, but this is likely to be more than offset by growth in sales jobs for this age group. Prime age workers are expected to experience further heavy losses in elementary, skilled trades and administrative roles, compensated for by the continued expansion of employment in managerial and professional roles, and personal services and sales occupations. Older workers are likely to see similar occupational shifts but will rely much more heavily on growth in personal services to maintain employment growth rates to 2020.

### Disability and health status

The annual employment growth rates for disabled and non-disabled people are projected to be roughly similar between 2008 and 2020. There is predicted to be some slowing of the rapid employment rate increase that people with DDA disabilities and health conditions experienced prior to the 2008/09 recession but over the medium term, the authors predict that employment levels for disabled people will return to pre-recession levels. The rate of full-time employment growth is projected to be similar for disabled and non-disabled people but part-time employment among disabled people is expected to rise faster than among non-disabled people. There is projected to be very little difference in the growth of employment by sector or occupation for disabled and non-disabled people

## Ethnicity

The employment growth rate is projected to be relatively similar for all ethnic groups to 2020. This is in marked contrast to the years between 1993 and 2008 when the employment rate for ethnic minorities was rising much faster than for white people. For example, the employment rate among black people increased by 3.4 per cent a year between 2001 and 2008, compared to 0.3 per cent a year among white people. Between 2013 and 2020, the employment rate for black people is expected to grow by just 0.6 per cent, and by 0.5 per cent for white people. This suggests that the trend towards converging employment rates between white and non-white populations may not return in the medium term.

## Conclusions: structural and cyclical employment challenges

The patterns of employment disadvantage during the 2008/09 recession are broadly in line with those in previous recessions. Using data covering the period 1974 to 2005, Berthoud (2009) found that low-skilled people tend to experience disproportionate falls in employment during recession. Conversely, the effect of recession on the employment outcomes of older people, women and disabled people tends to be negligible.

The evidence presented here demonstrates the interaction between structural and cyclical employment challenges. Among some groups, notably older people and disabled people, underlying rates of worklessness have not been significantly worsened by the recession. These groups experience a structural employment penalty but are not very sensitive to changes in the business cycle. As a result, while the rise in employment rates for these groups that preceded the recession levelled off over 2008/09, there has not been a significant decline in employment for most groups. The exception is men aged 50 to 64, although employment loss for this group has not been as large as among prime aged men.

Nevertheless, there are significant long-term challenges in increasing the employment rate among older people and people with a disability or long-term health condition. The scale of the challenge remains large given the extent of worklessness among these groups, the size of the populations, and current patterns of demographic change, primarily the growing size of the older population. The fact that employment rates among older people and some disabled people are expected to grow much slower than prior to the recession is of concern given the scale of employment increases required among these groups. Most older or disabled people without work are inactive rather than unemployed, so the challenge for policy is to find ways to encourage these groups to become economically active and find appropriate work.

In Berthoud's study of previous recessions, people from ethnic minority backgrounds tended to do less well in recessions than their white counterparts. This meant that their structurally weak employment position was compounded by cyclical falls in employment. However, this pattern is not evident in the 2008/09 recession. Black men and women, together with Pakistani and Bangladeshi men, have seen employment falls on a similar scale to their white counterparts, while Indian, Pakistani and Bangladeshi women saw relatively strong employment growth during the recession. However, the fact that employment growth is expected to be much slower among ethnic minorities than prior to the recession is of concern.

The weak and worsening labour market position of adults with no or only low-level formal qualifications has been further damaged by the recession, adding a cyclical problem on top of a long-term structural employment challenge. The employment prospects of this group should be of particular concern since, unlike the other disadvantaged groups, their labour market position is on a long-term downward trend and unlikely to improve as the recovery gains pace.

## 5. POLICIES IN PLACE TO PROMOTE GROWTH AND JOB CREATION

The analysis presented in the preceding chapters has highlighted the substantial challenges to the path back to full employment in the UK. In the short term, these include the risk of a jobless recovery and the likely repeat of hysteresis last seen on a significant scale in the 1980s. Over the longer term, challenges include the impact of public sector spending cuts and the continued evolution of the UK's industrial structure due to technological change and globalisation.

Creating the conditions needed to restore growth and create jobs is the most urgent task facing the Coalition government. Below we analyse the policy areas key to this: macroeconomic policy, welfare reform, and employment and skills policy.

### Macroeconomic policies for growth and job creation

The Coalition government's dominant narrative on growth is that the UK economy needs to be re-balanced, with less reliance on a narrow range of sectors and 'ever-increasing government spending' (HM Treasury and BIS 2010). However, despite publishing a 'Plan for Growth'<sup>27</sup> at the time of the 2011 budget, the government has appeared more focused on its deficit reduction strategy than on securing the economy's fragile recovery from recession. The emphasis was on removing bureaucracy, deregulation and prioritising action to 'restore UK competitiveness'.

Key policy decisions announced prior to the 2011 budget included cutting the budget deficit by reducing public spending by £95 billion over five years, incurring heavy public sector job losses expected to be filled by the private sector; reducing selected taxes, including the rate of corporate tax from 28 per cent to 24 per cent (its lowest rate ever) over the next four years; and cutting back on regulation – for example reviewing employment law to promote competitiveness, and amending health and safety rules (ibid).

Billed as a 'budget for growth', the 2011 budget broadly stuck to the same policies to boost economic growth, including a further cut to the corporate tax rate and additional reductions in regulation. It prioritised support for entrepreneurs and the creation of a more flexible workforce and introduced new 'old' policies such as enterprise zones to stimulate growth. Along with a more competitive tax system, it heralded exports and investment as key engines of growth for the UK economy (HM Treasury 2011).

These policies, many of which were popular in the 1980s, are unlikely – at least on their own – to result in substantial job creation. Policies to cut corporation tax rates and regulation will only take place over a number of years and are unlikely to result in increased investment or job creation (Dolphin 2011). Enterprise zones may boost investment and growth temporarily but previous experience shows that this is unlikely to be sustained over the long term. Evidence also suggests enterprise zones are simply likely to move jobs around and will have little sustained impact on economic growth (Sissons and Brown 2011).

The Coalition's key ambition of encouraging investment and exports as a route to a more balanced economy is an ambition shared by many governments around the world. However it is not a strategy that is guaranteed to boost growth. It overlooks both the UK's historical lack of investment and the extent to which trade is contingent on improvements in the global economy (Straw 2011). Without a convincing strategy to improve investment levels and support innovation, among other things, this is at best only a partial plan for national growth.

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27 See HM Treasury and BIS (2011)

## Deregulation

A review of employment law is the most recently announced measure to help stimulate private sector growth, with the government making the familiar argument that cutting 'red tape' will help businesses and improve growth in employment. The review will examine the penalties applied in discrimination employment tribunals, the administration of the national minimum wage, TUPE regulations and the consultation period for collective redundancies (BIS 2011).

The consultation period for collective redundancies could be shortened from 90 to 30 days. Given current rules on balloting for industrial action this would weaken the ability of trade unions to resist sackings before they happen. As well as compromising workers' rights, this would reduce the amount of time an individual has to find new employment. Yet some of the most successful practices in supporting people back into work have been pre-redundancy, at the earliest possible stage, through schemes such as ProACT in Wales (Dolphin et al 2011 forthcoming).

While some employers may welcome greater flexibility to hire and fire workers, deregulation is not necessarily a route to better labour market performance. The OECD has concluded that competitive markets are not dependent on weak employment protection legislation and that what matters more is a coherent package of policies which interact successfully (OECD 2006). There is also evidence to suggest that greater labour market flexibility reduces the incentive for employers to invest in and train workers and the longer-term costs of re-recruiting and training are often overlooked (Coats 2009). According to the OECD, the UK already has one of the most deregulated labour markets among the developed economies and it is unlikely that further deregulation will have a significant impact on economic growth.

## Fiscal policy

The Chancellor has stuck resolutely to his 'Plan A' as the only way to deal with the deficit and consolidate the recovery. However the recovery, such as it is, appears to have ground to a halt with only 0.2 per cent growth in GDP over the last three quarters (ONS 2011b). The National Institute for Economic and Social Research (NIESR) recently cut its growth forecast to 1.3 per cent of GDP for 2011 (0.4 per cent lower than the OBR forecast) and sees growth of 2.0 per cent in 2012 (0.5 per cent lower than the OBR) (NIESR 2011).

The full impact of the government's rebalancing strategy is yet to be felt, as the cuts to local authority budgets and central government departments are only beginning to take effect. Public sector job losses so far have been higher than many predicted at 81,000 since the second quarter of 2010. The government is confident that the private sector will fill the void in employment. Since the beginning of the recession in 2008, private sector employment has declined, though it added 449,000 jobs between the last quarters of 2009 and 2010 (ONS 2011a).

## Summary

The government's policies hark back to the 1980s: cuts in corporate tax rates and regulation, and enterprise zones. There is little evidence to suggest that these measures were successful then in boosting private sector growth and job creation, and it is likely that they will prove inadequate now. What is needed is a much broader set of policies, designed to tackle the economy's supply-side deficiencies, particularly in investment, infrastructure, innovation and skills.

## Stimulating sub-national growth

Sub-national economic development is a key strategic focus in the Coalition government's strategy for rebalancing the economy. The Local Growth white paper established four priorities (BIS 2010):

- national economic leadership to underpin the UK's global competitiveness
- enterprise partnerships to promote local economic development
- a Regional Growth Fund to promote private enterprise, especially in those areas lacking a strong private sector

- a better business environment to help all businesses start up and grow.

The Coalition government acted quickly to dismantle the architecture of regional development agencies (RDAs) established under the previous government, arguing that RDAs had failed in their task to close the gap in GVA growth between the greater South East and other English regions, and that they lacked democratic accountability. The functions of RDAs were split: core RDA activity such as promoting trade, securing inward investment and investing in R&D and innovation were drawn into central government, while the remaining areas – transport infrastructure, housing and planning, business regulation, employment and encouraging private sector growth – are to be the responsibility of newly established local enterprise partnerships<sup>28</sup> (LEPs)(BIS 2010).

However, although LEPs can prioritise any of these policy areas (regeneration and skills are two others) they will have no specific powers, other than the ability to establish an enterprise zone. Though employment and skills is within the remit of LEPs, they will have no devolved powers in these areas, despite this having been a popular theme in proposals submitted (Turley 2011). Skills funding will be routed through the national Skills Funding Agency straight to colleges and training organisations, so LEPs will be unable to use this important policy lever to influence and drive local economies. Similarly, the commissioning of employment support will be carried out by the Department for Work and Pensions (DWP), while large welfare-to-work companies will determine the nature and shape of strategy and delivery on the ground (see below).

Therefore the extent to which employment and skills will be integrated with local economic development is unclear. The experience of other bodies without specific powers in influencing outcomes in employment and skills is not promising. City strategy pathfinders for example, which were local consortia made up of public, private and voluntary organisations to tackle worklessness, were constrained in their effectiveness by a lack of commissioning powers (Green et al 2010).

### **Regional Growth Fund**

The Regional Growth Fund (RGF) is a key component of the rebalancing agenda, with successful bids for funds intended to create jobs in the private sector largely in areas where public sector employment is currently high but the private sector is weaker (BIS 2010). The government expects the funding to result in the direct creation or safeguarding of 27,000 jobs and the indirect (via supply chains or local economies) creation or safeguarding of a further 100,000 (though these figures are those given by RGF applicants and their accuracy cannot be guaranteed). Though the fund can be expected to make a valuable contribution in successful areas, at £1.4 billion over three years the RGF budget is equivalent to just one year's funding for all nine RDAs in 2010/11 – itself a reduction on previous years (Cox and Schmuecker 2010).

### **Local authorities and stimulating growth**

Local authorities are envisaged as having a key role in supporting business. The government is currently consulting on plans to allow local authorities to retain business rates in order to increase the financial incentive to promote local economic growth. It also hopes to enable 'tax increment financing' which would allow local authorities to borrow against growth in their local business rates. In the context of the UK's highly centralised system of governance these are positive moves which will give local authorities more autonomy to shape their local economic environment. But any changes will need to take into account the ability of different areas to raise different amounts of revenue and the differing levels of need for services delivered by local authorities (Schmuecker and Woods 2011).

Plans to increase local authority autonomy and revenue-raising powers also have to be seen in the context of dramatic cuts in local government budgets as a result of the deficit reduction programme. In addition to cuts in capital expenditure and the abolition of the RDAs, which were the lead agencies for job creation and growth at the regional

28 The composition of LEPs will vary from area to area as the process to select them was intentionally bottom up and light on prescription, but most LEPs will consist of collaborations between local authorities and their local economic partners, alongside strong business involvement.

level, employment and regeneration schemes such as those funded through the Working Neighbourhoods Fund have been among the hardest hit areas as local government has scaled back spending on services beyond the statutory minimum.

### Summary

Several of the reforms outlined above, such as the Regional Growth Fund and LEPs are promising for jobs and growth in theory but in practice they are either limited in scale or do not give sufficient power and funding to local partners. Local enterprise partnerships could offer prospects for much-needed integration of employment and skills with economic development, but they have a wide remit and limited capacity and are unlikely to have the influence over the commissioning, planning and funding needed to maximise the benefits of integration. Overall the task of filling the gap left by large public sector job losses is still largely in the hands of the private sector.

### Benefit reform

The context in which the UK government is attempting to move the country from recession to recovery is significantly different from previous recessions. The last 15 years have seen a strong focus on ‘supply-side’ policy to improve the productivity of the workforce. Active labour market policies have proven central to a well-functioning economy in the UK and demonstrated their worth in the recession – accounting for around a third of the lower-than-expected increase in unemployment (Gregg and Wadsworth 2011).

Efforts were also made by the previous government to develop human capital through improving skills; and to ‘make work pay’ through a suite of tax credits to supplement lower incomes and provide greater support for childcare. Changes to the tax and benefits system made work attractive for those previously on benefits, enabling many to move into employment (Dickens 2011).

While the Coalition government has only relatively recently begun to shape a plan for growth, plans to improve incentives to work and develop employability were in place early on in the Coalition’s term of office. In many respects the Coalition government has continued the direction of policy set by the previous government on welfare reform. Familiar principles such as promoting responsibility, incentivising individuals to move into work and increasing fairness between different groups in the benefits system were at the heart of the DWP 21st Century Welfare strategy paper (DWP 2010a). The Coalition’s initial focus in government has been on long-term reform of the benefits system to improve work incentives and an £18 billion programme of spending cuts to reduce the overall cost of the welfare bill.

### Universal credit

DWP’s cornerstone policy is the introduction of the universal credit to replace the system of means-tested benefits and tax credits currently available to working-age adults.<sup>29</sup> The aim is to improve work incentives by ensuring that work always pays more than out-of-work benefits, and to simplify the benefits system. The credit will consist of a basic amount with additional payments for disability, children, housing and caring responsibilities. The universal credit will gradually taper away, with the intention of easing the transition between work and benefits and reducing high marginal deduction rates for low-income workers (DWP 2010a). Current plans include the removal of the ‘hours rule’ in working tax credits, so that low-earners working less than 16 hours a week could receive support through the universal credit. This is designed to support returns to work for people who can initially only commit to a relatively small number of hours’ work a week, particularly people with health conditions or young children.

The universal credit is a bold and decisive step towards simplifying the benefits system and making work pay for more people. However it is not yet proven that it can deliver on this ambition, and changes to the original blueprint have undermined the intentions of the reform. The Dynamic Welfare report from the Centre for Social Justice, which originally

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29 The benefits that would be replaced by universal credit are: income support, income-based jobseekers allowance, income-based employment and support allowance, working tax credit, childcare tax credit and housing benefit



proposed the reform, set a withdrawal rate for the taper of 55 per cent (Centre for Social Justice 2009). Due to fiscal constraints, the withdrawal rate will actually be set at 65 per cent, which will mean almost two million workers will have worse marginal effective tax rates (METRs) than under the current system (CPAG 2011). The ability to make work pay has also been weakened by spending cuts. At least half the cuts to the welfare budget will hit working families, adding to the squeeze on living standards for those in work (IPPR 2010).

Analysis by the Institute for Fiscal Studies found that the universal credit will strengthen incentives to work for most people, particularly among low-earning single people and the first earner in a couple (Brewer et al 2011). However, second earners in a couple will face reduced incentives relative to the current system. Low-earners will also have stronger incentives to increase their earnings, but incentives to earn more will be slightly weaker for middle earners.

In addition the 'real costs' of work such as transport and childcare, which vary considerably across the UK, are not fully taken into account by the universal credit. Travel costs are likely to rise considerably in the next few years. For example, the spending review announced that rail fares will be allowed to rise by three per cent above inflation in the next few years (giving a rise of eight per cent in 2012).

The spending review saw the amount of support that working families can claim for childcare costs through the tax credit system cut from 80 per cent of total costs to 70 per cent.<sup>30</sup> The government is currently considering how childcare costs will be supported within the universal credit framework. The removal of the hours rule would mean that more families would be eligible for childcare support but the Treasury has made it clear it will not provide additional funding. This would mean that existing expenditure would be spread across more families and the entitlement of individuals currently receiving support would have to be reduced, thereby raising the cost of work for these families. However, families who are not currently eligible for support with childcare costs because they work less than 16 hours, or would like to, may see improvements in their work incentives.

A potentially positive change is the more generous 'earnings disregard' (the amount individuals can earn before any of their benefits start to be withdrawn) for some individuals and households.<sup>31</sup> As well as easing the transition between benefits and work this may create more flexibility by allowing individuals to gradually increase and vary their hours of work. This could help people who are moving back into the labour market after long periods out of work or those for whom only a few hours of work at a time are possible because of a disability or caring responsibilities.

The government has made it clear there will be some form of conditionality for everyone receiving the universal credit, including those in work. This does not currently exist in the working tax credit system and it is not yet clear what this conditionality will look like. It could include a requirement for low-wage workers to participate in training or seek careers advice. Trialling this as DWP is expected to do<sup>32</sup> will be important as administration will be complex. Applying conditionality rules in a system where the clear distinction between being in work and being on benefits is lost will be challenging for Jobcentre Plus and welfare-to-work providers.

### **Wider benefit reforms**

The spending review also introduced other reforms to the benefits system including shifting the up-rating of benefits from the retail price index (RPI) to the consumer price index (CPI), saving £13 billion, and the time-limiting of contributory employment and support allowance (ESA) to one year for people in the work-related activity group.

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30 IPPR research has shown that families claiming the maximum support for childcare could lose up to £1,500 a year. Working couple families will have to work an extra eight hours a week between them to be eligible for working tax credits – but as this might not be possible in the current climate, they could see their entitlement cut, making work less worthwhile (IPPR 2010).

31 The earnings disregard for a lone parent should increase to £5,000 and to £7,500 for a disabled household once the universal credit system is introduced (DWP 2010c).

32 See for example <http://www.guardian.co.uk/politics/2010/nov/14/welfare-reform-working-slivers-of-time>

Those wishing to claim ESA<sup>33</sup> and existing incapacity benefit claimants undergo a work capability assessment which tests their 'fitness to work' and allocates them to ESA or JSA accordingly, a process which began under the previous government. The government estimates that around a quarter of IB claimants will be transferred onto JSA as a result of the reforms and has predicted £600 million savings from this which will be used to fund the Work Programme (DWP 2011). The process has been heavily criticised in a review commissioned by the government and conducted by Lord Harrington (Harrington 2011).

The time-limiting of contributory ESA will affect an estimated 700,000 by 2014/15. It is likely that at least some of these individuals will feel compelled to search for work when their benefit is removed, although the precise impact is not yet known.

### **Summary**

Though the ambitions behind the universal credit are the right ones, many of the original intentions have been watered down because of the fiscal climate. The reforms risk substantial administrative upheaval for little gain on work incentives.

### **Employment-related support**

Our earlier analysis has shown how the economy will struggle to generate enough new jobs in the next five to ten years to restore full employment and how disadvantaged groups will find it particularly difficult to compete in the labour market. Employment rates for disabled people and the low-skilled remain significantly below the national average in recent years. The low-skilled are of particular concern as they have seen employment prospects worsen due to the recession.

Welfare-to-work strategies are now the main policy tool for improving employment rates, both in the UK and internationally. As we have seen, more active labour market policies do seem to have played a part in helping people back into jobs sooner than would otherwise have been the case. During the recession, the Labour government added to the existing suite of welfare-to-work schemes by introducing a number of emergency schemes targeted primarily at young people under the Young Person's Guarantee. This provided a guarantee of employment or training for young people who had been out of work for six months or more through programmes including the Future Jobs Fund (which provided a job paid at least the minimum wage for six months), work-focused training and internships. The Coalition terminated these schemes and reverted to standard welfare-to-work support.

However, the Coalition's welfare-to-work policy largely represents a continuation of the previous government's pre-recession approach, with a large-scale employment programme – the Work Programme – designed to remove barriers to work and secure jobs for the long-term unemployed. However a new set of financial incentives behind the payment system has been designed to improve support for the hardest to help and to help people stay in work for longer.

Though the spotlight has been shone on the Work Programme, many of the more substantial changes to labour market support will be seen over the next few years within Jobcentre Plus. Jobcentre Plus has the largest and most immediate role to play in improving employment rates: it is still the case that over 60 per cent of JSA claimants leave the benefits system within six months, and are therefore unlikely to enter the Work Programme (ONS 2011a).

### **Jobcentre Plus**

Significant changes are being made to the 'Jobcentre Plus offer' based on a number of trials which have been run to test the impact of increased flexibility for Jobcentre Plus district managers, centre managers and advisers. The success of these schemes and the wider moves towards increased flexibility and autonomy for providers of employment services means that Jobcentre Plus will gain similar freedoms from central control as in the Work Programme.

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33 ESA is replacing incapacity benefit (IB) and divides claimants into different groups according to the severity of their disability, providing greater conditional employment support.

Changes will include greater control over both resources and the highly rigid way in which adviser time is allocated. Greater financial freedoms will see Jobcentre Plus district managers given control over how to spend funding for lone parents and the discretionary fund which is used to ease people's transition into work. Greater autonomy for JCP centre managers and advisers will allow them to determine the nature of support they provide to individuals within minimum standards.<sup>34</sup> We could reasonably expect to see the impact of a less standardised regime in higher off-flow rates for those who have been unemployed for a short time. Differences in performance between offices could also act as a useful tool for performance management. However, the quality of support could be compromised by budget cuts affecting staff numbers.<sup>35</sup>

Another significant change is the enhanced sanctions regime, including the introduction of mandatory work-related activity where advisers will be able to compel jobseekers to undertake four weeks of full-time unpaid work if they think it would help their chances of finding a job, based on the US 'workfare' schemes. If jobseekers do not comply with the requirement, they risk losing their jobseekers allowance for three months, or for six months for a second offence and three years for a third offence (DWP 2010c). Reliable and even judgement from advisers will be needed, along with careful guidance, to ensure this measure is used only as a last resort. An equal risk is that excluding people from the benefits system runs the risk of removing the conditionality and support that is more likely to help them find work again. However the actual impact of this measure is hard to gauge, as evidence from the US, where workfare has been a feature of the welfare system for over a decade, suggests it is now used infrequently (Anderson et al 2010).

Jobcentre Plus showed great resilience during the recession, adapting to significantly higher volumes of claimants at the same time as the introduction of ESA. But challenges remain in linking effectively into the local labour market and providing claimants with relevant and timely information about job and training opportunities (McNeil 2010). This will be particularly important over the next few years as the full impact of public sector job cuts is felt. In the short term Jobcentre Plus could play a vital role in efforts to support re-training, linked to local labour market needs.

### Work Programme

Despite the Coalition government's presentation of the Work Programme as 'revolutionary' and 'transformative'<sup>36</sup> the programme represents an evolution of the New Deal programmes it replaces.<sup>37</sup> The key policy goals of the programme are to improve job outcomes for the long-term unemployed and to increase the sustainability of employment for those moving into work from the Work Programme (DWP 2010a).

To the jobseeker the Work Programme is unlikely to look or feel very different to its predecessors. However it will differ in several key respects which relate mainly to the further marketisation of the welfare-to-work sector. As Mark Fisher, Jobseekers and Skills Director for DWP explains: 'In a sense, what we have not built here is an employment programme; what we have built is a set of financial incentives to help get people back into work'.<sup>38</sup>

First, the Work Programme firmly entrenches the prime provider model, which was the basis of welfare reforms in New York City (see McNeil 2010). This means fewer and larger companies at the top, sub-contracting with several layers of smaller organisations to form supply chains. Instead of DWP commissioning and contract managing several hundreds of organisations, it will now deal with 18 large-scale providers, so as to reduce complexity and administration.

34 For example jobseekers who are not deemed by advisers to need support will only be seen by advisers for a minimum of every two weeks and those who need more support could be asked to sign on as often as daily.

35 Reports suggest cuts at Jobcentre Plus over the next 12 months include the loss of 17 benefit processing centres and five contact centres, representing nearly 20 per cent of staff. See for example <http://www.guardian.co.uk/politics/2011/may/12/job-centre-posts-cut-2400>.

36 Rt Hon Chris Grayling, speech 3 February 2011. <http://www.dwp.gov.uk/newsroom/ministers-speeches/2011/03-02-11.shtml>

37 The Work Programme replaces Flexible New Deal and New Deal schemes, employment zones and Pathways to Work.

38 House of Commons Oral evidence taken before the Work and Pensions Committee Work Programme: Providers and Contracting Arrangements, Monday 14 March 2011 HC 718-iii.

Second, providers will be rewarded on a payment-by-results basis designed to transfer the burden of risk from the government to providers. Providers needed large reserves of capital to compete for prime provider contracts in which over a half to two-thirds of the payments are 'backloaded' (payable only after an individual has been in work for 13 or 26 weeks depending on the benefit an individual receives), requiring providers to effectively self-finance their programmes for at least the first year or two.<sup>39</sup> The backloading of payments is an attempt to focus the efforts of providers on helping individuals to stay in the labour market – incentivising them to help sustain their clients in work and prevent them 'churning' between work and benefits.

The programme is also the first in the UK to operate the DEL:AME switch.<sup>40</sup> Simply put, this means that where a provider is successful in supporting an individual into work they will be paid using the net savings from future unclaimed benefits up to a specified limit. Though the government had intended a 100 per cent payment-by-results system, concern from investors about backing an untested scheme meant that a limited upfront payment was awarded to providers.<sup>41</sup> However, this will decline in value each year from the second year of the contract until the fourth year when no upfront fee will be paid.

In order to prevent providers from under-performing, the minimum performance requirements for the Work Programme are being set at the maximum that New Deal programmes achieved over the last decade. It has been projected that the average spend per participant will be £1,347, which is less than on previous similar programmes (Inclusion 2011), though this will be subject to factors including both volumes of the long-term unemployed flowing into Work Programme and providers' performance offers. Bids were marked on criteria relating to both quality and price. In some areas, discounts were offered on performance offers. It will be important that delivering on these offers is not achieved to the detriment of quality of service.

### **Improving employment outcomes for disadvantaged groups**

The Work Programme supports a greater proportion of those among the most excluded than the previous New Deal schemes. Reforms to IB and the introduction of conditionality into the ESA regime, mean that those currently or formerly on 'inactive' benefits could account for around 27 per cent of total Work Programme volumes (DWP 2010a).

As part of a system of differentiated payments there will be higher than ever before sums available for placing and sustaining the 'hardest to help' groups in work – around £6,000 for those in the ESA work-related activity group and around £14,000 for those in the ex-IB work-related activity group and support group (DWP 2010a). The aim is to provide a strong financial incentive for providers to work with these groups and prevent 'creaming and parking' – where the easiest to place clients get most support while those further from the labour market are neglected.

DWP expects to see a step change in outcomes for these groups as a result of higher available payments. Though the incentives here are strong, provider behaviour may not follow as intended. The differential payment system for the Work Programme is a marked improvement on the previous flat fee structure but it is still fairly crude. Fees are based on the benefit group an individual belongs to, rather than their individual barriers to work and yet there are significant variations in barriers to work within benefit groups. There are small additional payments for some within benefit groups, but for ESA and ex-IB claimants these payments are too small to mitigate the variation in conditions and costs associated with getting them back to work.

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39 Backloaded payments range from 53 per cent (group 5) to 64 per cent (group 2) for groups 1–7. However, discounts were offered by providers on job outcomes for groups 1, 2 and 6 for different periods of the contract.

40 The Departmental Expenditure Limit (DEL) budget pays for welfare-to-work programmes whereas benefits are paid from the separate Annually Managed Expenditure (AME) budget. The DEL:AME switch allows expected savings from the AME budget to be routed into the DEL budget to support additional spending on the Work Programme.

41 The extent to which there will actually be a transfer from AME to DEL for the programme also appears unclear at this stage.

Within groups we can therefore expect that some individuals will be easier to help back into work than others, which may mean they are prioritised for support. Shifting overall patterns of disadvantage in the labour market will therefore remain a challenging task under this system. Bowman and Horn (2010) argue that in Australia weighting payments towards the most disadvantaged has not resulted in higher levels of support or a more personalised service. However fees in Australia for the hardest to help group are a maximum of 1.4 times the amount for the standard group. In the UK the ratio is twice that, at three times the amount available. It will be important that there is a mechanism for learning lessons throughout the lifetime of the contracts so that the system can continue to evolve.

The structural challenges in the labour market will also be highly challenging for providers to overcome. Disadvantaged groups tend to be considered by employers to be less productive or more costly to employ than other workers. As unemployment remains high and long-term unemployment continues to grow, prospects for disadvantaged groups will remain uncertain. More significantly, private sector employment growth particularly in the North, Scotland and Wales will need to accelerate rapidly if big reductions in inactivity and unemployment rates among disadvantaged groups are to be absorbed (Fothergill and Wilson 2007). In the absence of this growth, the most likely outcome in these regions is that most or all of any reduction in health-related benefit numbers will simply boost the numbers in other jobless groups, primarily JSA claimants.

The higher payments available do however present opportunities for prime providers to find innovative solutions if they are willing to take a risk. And though the Work Programme does not necessarily provide secure investment for smaller providers working with harder to help groups, it is a stable funding stream at a time when other sources of funding are disappearing.

### **Sustainability and advancement**

The second of the specific policy goals of the Work Programme is to increase the average length of time in employment for people returning to work. To incentivise this, the majority of Work Programme payments to providers will be made after an individual has been in work for 26 weeks (or 13 weeks for those in 'harder to help' groups). This is expected to incentivise better job-matching so that an individual is more likely to stay in their job and to prevent 'churn' between benefits and employment.

The standard support of information, advice and guidance offered by providers is likely to need to change to support some individuals to keep their job past nine or twelve months, so this incentive is expected to create variations in the current model. As well as improving the match of an individual to a job, some providers are considering models of ongoing careers support and/or up-skilling as a way of moving an individual into more stable and suitable employment. Equally we can expect to see a stronger emphasis placed on working with employers to secure more stable employment for their clients.

Achieving better job matching is critical to overall labour market performance. Elsbey and Smith (2011) have suggested the UK's record is not as strong as it should be in this respect. In the UK, unemployment change is caused more by outflows from unemployment than inflows; in other words, most people are out of work because they lost their job rather than because they cannot find a job, suggesting there is a problem with the efficiency of job matching. In a best-case scenario, the incentives to sustain individuals in work could improve efficiency, as placing people in a job that suits them well means they are more likely to remain in that job.

Providers need to keep a person in work for 30 or 17 weeks depending on the benefit group to start gaining 'sustainment' payments. There is no requirement for that person to be employed in the same job – a provider could continually place an individual in short-term, temporary work to keep securing sustainment payments. This would only be damaging if it became an end in itself. Moving between jobs can improve job matching and enable progression (Andersson et al 2006). In certain parts of the country however it may be difficult to avoid individuals finding themselves caught in a 'temporary work

trap'.<sup>42</sup> There is a limit to the extent to which any supply-side policy can address the shortcomings of the labour market. This is particularly true for the Work Programme which is serving a section of the labour market that is defined by low-paid and insecure jobs (Ben-Galim et al 2011).

The market could respond in a number of ways to the financial incentives set in place by DWP and there is a considerable degree of financial uncertainty around the new payments system and the untested funding mechanism.

### Summary

There are a number of 'known unknowns' in relation to the Work Programme. There are risks of further standardisation rather than personalisation. There have been warnings that the financial pressure on providers could result in low standards of service, reduced numbers of personal advisers and higher caseloads (Inclusion 2011). The relatively long length of contracts – five years with a further two years support – should allow providers time to learn from mistakes and improve. But the Department is hoping for a step change in results on previous programmes and will be keen to ensure that its flagship programme is delivering in the short term as well as the long term.

### Skills

A key policy agenda under the previous government was the integration of employment and skills – often treated as separate areas of policy despite being inextricably linked. Though there has been progress at a local level, this has not been supported by national processes (UKCES 2011). Improving integration between employment and skills can help move individuals into work with the skills they need to progress, while helping businesses grow. We assess reforms to the skills system and explore links with employment-related support below. As skills policy in Scotland and Wales is devolved we focus here on England.

The English skills system has undergone significant structural change over the past five years. After the 2006 Leitch Review of Skills, the system was reformed from one which was centrally planned by training providers and skills funders into one nominally led by employer demand (Leitch 2006). Sector skills councils were created to represent the training requirements of employers in their particular sector and to feed this into the skills funding agencies operating in the four countries of the UK.

However problems began to appear with the way the system was restructured. These primarily concerned the extent to which employers could be relied upon to anticipate and articulate demand for skills. Challenges included the sometimes short-term horizons of employers (particularly small businesses) which meant many were unable to plan for skills needs five or 10 years hence (see for example Bird and Lawton 2009).

As a result of these problems but primarily in response to the rise in employment generated by the financial crash, the previous government set out a more strategic approach to skills policy as part of its emerging 'industrial activism' strategy (see BERR 2009). It signalled going beyond a supply-led approach to anticipating demand in areas of potential future growth in the economy where securing the UK's competitive advantage was deemed critical (DECC 2009). The Coalition government does not appear to be continuing with a more 'activist' approach to skills and growth.

### Coalition skills policy

The recent Skills for Sustainable Growth paper suggests that the Coalition will continue with an employer-led approach to skills, preferring to influence outcomes by pledging to co-fund training programmes in 'new or rapidly changing parts of the economy', or in areas where skills gaps persist, such as leadership and management skills in small and medium enterprises (BIS 2010).

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42 Unison found that two million temporary workers are trapped in temporary contracts which leave them with low pay, stagnant careers and uncertain futures. Temporary workers traditionally report lower levels of job satisfaction, receive less work-related training and are less well paid than their counterparts in permanent employment. <http://webcache.googleusercontent.com/search?q=cache:25BdMKHUUSEJ>

The Coalition has focused policy on areas it believes will deliver a strong return on investment. The most substantial investment is in the apprenticeship system, with the aim of strengthening vocational routes into employment. It also prioritises support for SMEs to help small employers train low-skilled staff, as well as adult and community learning.

### **Apprenticeships**

Apprenticeships are at the heart of the government's skills strategy. In the 2011 Budget, the government announced that in addition to the £1.4 billion apprenticeship programme already in place it would provide £180 million for up to 50,000 additional adult apprenticeship places over the next four years, bringing the total number of additional apprenticeship places planned by this government to 250,000 (HM Treasury 2011b). This is part of the Supporting Youth Employment package funding 100,000 work placements for young people over the next two years (PM Office 2011).

Low employer demand for apprenticeships remains a challenge. In 2009, only eight per cent of employers offered apprenticeships in England compared to a third of employers in Australia and a quarter in Germany (Steedman 2010). A focus purely on maximising uptake however obscures the important issues of ensuring that the quality and nature of apprenticeships created reflects the needs of employers and of the workforce. There is evidence that the quality of apprenticeships varies widely across sectors and is poorer in sectors that have little tradition of apprenticeship, such as retailing (see Lawton and Norris 2010).

As the Wolf Review (2011) has pointed out, much vocational learning for 14–19 year olds currently fails to deliver qualifications that have real value in the labour market. Progression routes from lower to higher level apprenticeships are weak – young people with lower skills or greater barriers to the labour market often do not have the qualifications needed for higher level (level 3) apprenticeships and lower level apprenticeships can be less meaningful in terms of employment opportunities and wages (Work and Pensions Select Committee 2011).

The government appears to have recognised this need, for example with the aim of developing a 'ladder' of training so that individuals can readily understand progression routes and offering young people who do not wish to take up an apprenticeship a state subsidy for training provision (ibid). However the Work and Pensions select committee has recommended that lessons be learned from the Future Jobs Fund on how to prepare young people furthest from the labour market for apprenticeships.

Beyond providing a subsidy to employers, policy and practice is relatively undeveloped around apprenticeships in the UK. In other countries such as Germany, strong institutions have been built which protect and enforce qualifications and standards. Because all employers must invest in and enforce standards, this also serves to avoid the problem of 'free-riding' – reluctance among employers to train an individual when they might be 'poached' by other employers.

### **Skills for Growth**

A £50 million demand-led growth and innovation fund has been set up, co-funded by employers, to provide targeted help for employers to overcome barriers to growth within their industries. An estimated £25 million of the funding will support new projects and £5 million will sustain pilot Joint Investment Programmes agreed in autumn 2010 with five sector skills councils. The other £20 million a year will support SMEs with training to develop leadership and management skills (UK Commission for Employment and Skills 2011). The fund could make a useful, if modest, contribution to helping to drive growth, particularly in sectors with skills gaps (less so in sectors that do not rely on innovation to increase productivity and need support to overcome barriers to growth). However, this has to be seen in the context of the much greater investment in intermediate skills through the Train to Gain<sup>43</sup> scheme worth £1 billion in 2010, which has been ended.

The Coalition will continue to either fund or co-fund qualifications at levels 2, 3, or 4, depending on an individual's age and existing qualifications, though some entitlements will

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43 Train to Gain was quite widely criticised for using public funds to pay for training that companies arguably would have done anyway without the extra funding.

drop off after 2013/14 – for example co-funding of levels 3 and 4 for individuals who are 24-plus will be replaced with a loan (BIS 2011). It will continue to focus on increasing the numbers achieving level 2 to 4 qualifications (as compared to international benchmarks). As part of its desire to reduce regulatory burdens on employers, the Coalition has ruled out extending an employee's right to request time off for training to firms employing fewer than 250 workers. Employees in larger organisations have had this right since April 2010.

What is missing is a stronger focus on driving improvements in the content and quality of vocational qualifications. Level 2 qualifications for example have been shown to have particularly poor wage and employment returns in the labour market (Lawton 2009). Another key question not being addressed is how to drive employers to actually want to use a more highly skilled, productive workforce. Poor utilisation of skills, particularly in low-paid sectors has been a persistent problem for the UK. This both limits workers' productivity and contributes to a problem of underemployment where the skills individuals have gained are not applied (Lawton and Norris 2009). Other countries, such as Scotland and Australia, have developed skills utilisation strategies to tackle this problem.

### **Summary**

The employer-led approach the Coalition is taking to skills policy can be successful in helping to ensure that qualifications developed and supplied are genuinely needed. But relying on employers to determine the supply of skills can also lead to difficulties where employers do not invest in or accurately articulate demand for skills. It is unlikely that relying on employer demand will be sufficient to ensure that the right skills will be in place at the right time to meet demand or to drive innovation.

As these difficulties could hamper potential growth, there is a clear role for government in helping to ensure that future skills needs are anticipated and that strategic skills planning is linked to the wider economic context in England. The UKCES strategic skills audit has highlighted the importance of a forward looking approach to forecasting and planning new skills needs – such as for the low-carbon transition – and the importance of government intervention to stimulate demand (UKCES 2010).

There is a need for a different approach to policy that continues to place strong emphasis on employer demand but also gives regional, sub-regional and central agencies a role in identifying, and planning for, future skills needs. As well as identifying future skills needs this would place a stronger focus on promoting shared knowledge, better innovation and investment.

### **Conclusion**

Coalition government reforms so far have not attempted to deal with some of the wider demand-side problems in the labour market. These include the trade-offs between an increasingly flexible labour market and greater numbers in insecure and low-paid jobs, which see many trapped in 'low-pay/no-pay' cycles, and the polarisation of the labour market between lower-skilled and higher-skilled jobs and growing wage inequalities (Machin 2011).



## 6. STRENGTHENING POLICIES FOR FULL EMPLOYMENT: RECOMMENDATIONS

Analysis in this report has shown that the Coalition government's plans for growth and job creation are unlikely to be sufficient to meet the combined challenges of high unemployment and growing labour supply over the next few years. In this final chapter we set out some options for promoting a quicker return to full employment in the UK. These focus on promoting growth and limiting the expansion of long-term unemployment.

We begin by looking at macroeconomic policy, proposals for job subsidies and the case for a modern industrial strategy to help support strong private sector growth. We then explore different policy approaches to avoiding the hysteresis effects associated with recession, by moving the recently unemployed back into work quickly and supporting job creation for the long-term unemployed. Lastly, we suggest that more support for childcare will be necessary if the UK is to increase its employment rate eventually to 80 per cent.

### Macroeconomic policy

From the moment George Osborne delivered his first budget in June 2010, setting out the Coalition government's plan to cut the fiscal deficit, there has been a debate about the appropriate speed of deficit reduction in the UK, the right mix of spending cuts and tax increases and the need for a 'plan B'. Despite disagreeing with the Coalition's approach (see Dolphin and Lent 2011), we did not intend to go over that debate again in this paper, believing that the government had no intention of changing course in the short term and preferring therefore to focus on alternative policies concerned more directly with the labour market and the medium-term outlook for job creation.

However, there has been a significant loss of economic momentum not just in the UK but globally in recent months and economists and global stock market investors think the risk of a 'double-dip' recession has increased. If this happened, recent employment gains in the UK would be reversed. The need for a policy response has therefore become imperative.

The causes of the recent economic slowdown are complex, but two factors dominate. First, high oil and food prices. These have squeezed households' spending power and companies' profit margins, resulting in weaker domestic demand across developed economies (in the UK, retail sales have been flat for the last year). As a result, manufacturers have seen orders fall and they are now cutting production in response. Second, the withdrawal of fiscal stimulus – either actually (as in the UK with the VAT hike and cuts in public spending) or in prospect (as in the US). This is taking demand out of economies now and creating uncertainty about future demand which makes companies reluctant to recruit new staff and to expand their investment plans.

What are required therefore are measures to support demand.

The government has limited room for manoeuvre on fiscal policy, but that does not mean it has none at all. Bond yields in the UK are at record low levels and the economy has grown by just 0.2 per cent over the last three quarters. In these extreme circumstances, the Coalition should ease the pace of fiscal tightening. This could be achieved through tax cuts. A cut in VAT is appealing because it could be implemented very quickly – and the evidence from 2009 is that it would support demand – or a cut in income tax targeted at the less well-off who are likely to spend most of the proceeds would also be effective (though the latter would take longer to implement and feed through to the economy). Alternatively, the government could increase capital spending, which it plans to cut substantially over the next four years. This would support employment in the construction sector in the short-term and help build the infrastructure required to promote growth over the medium-term.

The Monetary Policy Committee also needs to do its bit. At its August meeting it passed up on the opportunity to increase the scale of quantitative easing (QE) from its current level of £200 billion. There are grounds for doubting the effectiveness of additional QE on its own when consumer and business confidence are slumping, but combined with a fiscal easing it could help to support demand and growth in the economy.

These measures would not, on their own, guarantee the UK avoids a double-dip recession. That will depend on the oil price, the verdict of the credit rating agencies on US sovereign debt, and whether speculators are successful in widening their attack on European debt markets to encompass Italy, or even France. These global headwinds are outside our control. But policymakers in the UK should use what room for manoeuvre they have in a coordinated attempt to counter them.

**Recommendation:** The government should announce a £5 billion increase in capital spending to improve the country's infrastructure and boost employment in the beleaguered construction sector. The Monetary Policy Committee should increase quantitative easing by £50 billion now, with the option of a further £50 billion in three months' time if the economic outlook has not improved.

Governments have historically sought to support employment by subsidising non-wage labour costs, primarily by offering employers discounts on payroll taxes, such as national insurance contributions. Job subsidies can be either 'stock' or 'hiring' subsidies. Stock subsidies are designed to limit redundancies by subsidising existing employees. Hiring subsidies are designed to boost new job creation by providing a subsidy only for new recruits. Both stock and hiring subsidies can be gross or marginal. Gross subsidies provide support for all existing or new jobs, while marginal subsidies are restricted to jobs that are genuinely new, in that they would not have been created without the subsidy, or jobs that are directly at risk and would be lost without a subsidy.

Stock subsidies are most appropriate for the early stages of recession when lay-offs are rising rapidly, because they are designed to protect existing jobs. However, gross stock subsidies tend to be very expensive, poorly targeted and have high deadweight costs (OECD 2010b). Given where we are in the business cycle, stock subsidies would not be appropriate for the UK currently.

Hiring subsidies are most effective in the early stages of recovery, when the priority is to reintegrate people who lost their jobs in the recession (or were unable to find one if they were unemployed going into the recession) back into the labour market. This is clearly the priority for the UK labour market at the present time.

Gross hiring subsidies tend not to increase overall employment levels, although they can help disadvantaged groups compete in the labour market if well-targeted (ibid).

Marginal hiring subsidies appear to offer the best prospect for boosting job creation in the early phases of recovery. They are likely to be particularly effective if targeted at the long-term unemployed and young unemployed people, who might otherwise struggle to find work. However, because there are additional eligibility requirements, marginal hiring subsidies tend to be more complex to administer, and it may be that the additional administration costs outweigh the benefits of targeting. One well-studied example is the new jobs tax credit that operated in the US in 1977 and 1978. It appears to have been effective in significantly raising employment (ibid).

The OECD notes that marginal hiring subsidies have been relatively little used in the 2008/09 recession and subsequent recovery, probably because they are perceived by governments to be complex to run, given the tight restrictions that are required to ensure subsidised jobs are genuinely new. This follows governments' experiences of operating such schemes in the 1980s and 1990s. However, the OECD argues that learning the lessons from previous schemes would enable governments to develop simpler and more cost-effective schemes, particularly since they have proved capable of operating short-time working programmes during the recession.

However, the latest evidence from the UK is not promising. A year ago, the Coalition government announced a scheme that would provide small businesses being set up outside London, the South East and the East of England with a national insurance holiday for the first ten employees hired in their first year of business. It was hoped that 132,000 enterprises would sign up for this scheme in its first 12 months. In fact, only 5,137 applications were granted between September 2010 and June 2011.

Perhaps this should not come as a surprise. Arguments that cuts in employers' national insurance contributions (NICs) or other forms of wage subsidy will boost job creation are based on the idea that lower employment costs will boost demand for labour. However, employers might respond by increasing wages instead of utilising more labour and some studies appear to confirm that this is a more likely outcome.

The Institute of Employment Research (1999) produced a largely negative assessment of the WorkStart pilot studies run in the UK between 1993 and 1996 that were designed to use various types of wage subsidy to reduce long-term unemployment. Bell et al (2005) looked at the impact of changes to national insurance in 1999, when the threshold for paying NICs was raised and rates were increased (measures designed to reduce the costs of employing low-wage workers). They found that the changes affected wages and, to a lesser extent, working hours, but not employment. Similarly, Korkeamäki and Uusitalo (2006) found that a Finnish scheme to boost employment in certain regions of the country by cutting payroll taxes so that wage costs fell by about three per cent also had no statistically significant effect on employment.

Calls for the Coalition to abandon its plans for cuts in the corporate tax rate and use the money to cut the rate of employers' NICs instead therefore appear misplaced. However, cutting corporate tax rates is not the best way to promote employment growth in the UK. Corporate tax cuts tend to benefit large finance and other businesses that do not provide much employment. Profit margins are already at healthy levels and such companies are sitting on large cash reserves that they are reluctant to spend because of the uncertain economic outlook. It is not clear why a lower corporate tax rate should in these circumstances help the economy, and help jobs growth in particular. The revenues the government will forgo by cutting corporate tax rates could be better used to promote employment.

**Recommendation:** The government should abandon its plans to cut corporate tax rates further, saving around £2 billion by 2014/15 that could be used for other measures to promote employment in the UK.

### Modern industrial policy: boosting business investment and innovation

In chapter 5, we highlighted concerns about the ability of the Coalition's growth plan to secure a strong and sustainable economic recovery. Previous experience suggests relying on a combination of fiscal tightening, further labour market deregulation and untargeted corporate tax cuts is unlikely to generate the growth needed to create full employment in the medium term. This will be even truer if households seek to reduce their debts in coming years, leading to a period of sluggish growth in consumer spending.

It is not difficult to identify supply-side deficiencies in the UK economy – in the areas of innovation, investment (particularly in infrastructure), productivity and skills. Nor is it difficult to look at other countries where they do things better to find ideas that could be brought to the UK as part of an active industrial policy, whether it is a state investment bank, encouraging life-long learning or supporting the commercialisation of research ideas. But this has been true for many years. Policymakers need to focus more on the effective delivery of policy in these areas.

A modern industrial policy, designed to support growth in the private sector so that the UK can reduce, or even eliminate, its trade deficit and return to full employment as swiftly as possible, would also draw on new ways of thinking about the economy. It would be based on a vision of what the economy might look like in 2020. Such a vision is unlikely to be right in every detail of course. But we can be reasonably confident about some of the

major trends that will occur over the next decade – the ageing of the population and the continued development of emerging economies for example. We can also be clear about the trends we wish to see in the UK economy – better balanced growth – and identify what needs to happen, by way of investment in infrastructure and skills for example, to bring about the desired outcome.

An active industrial policy is not an optional extra in a modern economy, it is a necessity. Full employment will require policies that ensure UK companies continue to attract investment from overseas, have the infrastructure they need to support growth, exploit their existing comparative advantages to the full, and develop new ones. This is not about the government spending more money but about spending the existing budget more wisely. It is also about using public policy to create the right environment for companies to flourish through shaping markets, boosting competition, supporting ambition and entrepreneurship, and encouraging more diverse forms of business ownership and greater long-term thinking.

**Recommendation:** Rather than rely on corporate tax cuts and deregulation, the government should produce a new ‘Plan for Growth’ – a modern, active industrial policy for the next decade based on the latest economic thinking and best practices from overseas, designed to promote growth in the private sector and rebalance the economy.

One area in which the UK is particularly weak is business investment. Full employment will require more job creation in the private sector, which in turn will require more business investment. Over the last three decades, total investment (by government, households and businesses) in the UK has consistently lagged behind levels in Germany, the US, Japan, France and others (Lent and Nash 2011). A particularly large gap has opened up since 2003, with UK business investment remaining at around 10 per cent of GDP, while in the US, Germany and France it was 11.7 per cent, 12.3 per cent and 12.7 per cent respectively in 2008.

It has been argued that the UK has a lower rate of business investment because of the country’s reliance on services, which are less capital intensive than manufacturing. However, the UK had a relatively low rate of business investment 30 years ago, when manufacturing made up a greater proportion of GDP and the industrial structure of the UK now is not dissimilar to that of most of our competitors. In fact, the central problem in the UK is that, investment has tended to focus on the finance and property sectors. This has helped to create an unbalanced economy: one aspect of which is the fact that the UK has run a trade deficit in 23 of the last 25 years and in every one of the last 14.

Compared to our competitors, the UK is also weak on R&D spending, lagging behind Germany, Japan, France and US since 2002. The weakness of R&D is particularly evident in some growth sectors such as broadband services and environment-related industries, although the UK invests significant sums in health and biotech R&D (ibid).

These weaknesses in the UK have long been recognised, but policy approaches that have been based on economic planning and competition policy have had limited impact in closing the gap between the UK and its competitors. What unites those countries where business investment is higher than in the UK is the presence of some form of direct state involvement in business investment. The argument for state involvement in business investment is fairly straightforward: corporate lenders tend to be entirely driven by the security, speed and size of investment returns, making them less likely to lend to small firms or firms operating in risky growth sectors. The state, on the other hand, can accept lower returns, slower timeframes and higher risk, and so can invest in areas that would otherwise struggle to get lending in the private sector

In Germany and the Nordic countries, state investment banks help to support and direct business investment. In both cases, state investment banks use the ability of the state to guarantee loans to business at lower interest rates or to make loans that would otherwise be rejected by private lenders. Corporate customers apply to their own private bank and the application is passed to the state bank. Applications are judged against the

banks' strategic objectives, which focus on promoting SMEs and start-ups, renewable energy and other low-carbon investment, and infrastructure. In 2009, the German state investment bank KfW lent €384 billion and made a profit of €1.1 billion.

Rather than running a state investment bank, France operates a large strategic state investment fund to support business investment in key areas. In the US, there are a number of private sector business investment companies that lend to SMEs and innovative firms, facilitated by a complete state guarantee for all funds lent.

However, a fully-fledged state investment bank has a number of advantages. First, it has the capacity to raise large amounts of funds on the commercial markets. Second, a bank can be operated on a commercial basis with an independent board, making it less prone to political influence on investment decisions. Gerald Holtham has also highlighted how in the present circumstances – with the government able to borrow for 20 to 50 years at an interest rate of less than four per cent (or at a real interest rate on index-linked bonds at less than one per cent) – projects that are marginal with private finance become economically viable if backed by a state investment bank (in Straw 2011).

The Coalition government has already accepted the principal of a state investment bank by launching the Green Investment Bank. Although this is a positive move, the bank suffers from two key weaknesses. First, it is too narrowly focused on low-carbon goods and services, and provides no support for other growth sectors in the UK that struggle to find investment funds on the open market. Second, the initial capitalisation of the bank is too low to generate the required investment. It has been estimated that double the allocated capital of £3 billion is needed for low-carbon businesses alone.

**Recommendation:** The government should expand the Green Investment Bank into a fully-fledged public investment bank, with a lending strategy focused on SMEs, innovative firms, high-growth firms and infrastructure, as well as low-carbon sectors. Its initial capitalisation should be increased to £15 billion and it should be able to raise funds on capital markets immediately, rather than having to wait until 2015.

### Social care sector

One future trend that we can be very confident about is the ageing of the UK's population over the next few decades. This will create potential problems, mainly concerning the effects on the public finances, but it will create employment opportunities too, particularly in the area of social care. Our analysis in chapter 3 identified social care as a significant employer and a key growth sector, with potential to play a considerable role in supporting employment expansion in coming years. Yet it is a sector that currently fails to attract sufficient workers due to systemic problems with pay, working conditions and progression opportunities.

The fundamental challenge for the sector lies in increasing the level of funding available to pay for social care, enabling commissioners and providers to spend more on the care workforce. This would both relieve immediate pressures which prevent carers spending sufficient time with clients (lowering the quality of care and adding significantly to workplace stress) and in the longer term, facilitate improvements in skills and productivity that could translate into higher wages, greater job satisfaction and higher quality care (Bradley 2011).

Increased funding for social care at a time of large cuts to local authority budgets and enormous pressures on the NHS seems unrealistic in the immediate future. The recently published Dilnot Commission on Funding of Care and Support charts a new settlement for the adequate and sustainable funding of social care, with responsibilities for both individuals and the state. However, it may be some time before the Commission's recommendations are enacted and a significant improvement in the funding situation for social care is achieved.

In the meantime, there are some actions that could be taken to improve the attractiveness of the social care sector to workers (Bradley 2011):

- A single professional body should be created to support training, provide information on career options, and represent the workforce. A number of bodies currently exist that do some of this, but the sector lacks a central organisation that provides easy access to information, such as that provided for health workers by NHS Careers.
- Local authorities and health services should pilot the use of ‘super carers’ – people qualified to deliver both health and social care – in order to raise the status (and pay) of caring. This would require health and local authorities to pool budgets and jointly commission services, a process that could be overseen by the new health and wellbeing boards.
- Care providers can improve working conditions and reduce stress for care workers by giving them more flexibility and autonomy in their work.

### Improving performance on short-term unemployment

The lower than expected rise in unemployment during the recession is one of the few positive stories of the past few years in economic terms. However, this is no guarantee that the labour market will continue to out-perform during the recovery. Indeed, a detailed analysis of job finding rates suggests the right ingredients are present for future increases in long-term unemployment to the same levels as seen after the 1990s recession (Elsby and Smith 2010).

A swift economic recovery to boost demand and therefore job vacancies is the most important factor in averting such a rise. But Elsby and Smith have also shown that the job finding rates of the newly unemployed are highly influential in driving future reductions in UK unemployment. They explain how the rate at which the newly unemployed return to work regulates how quickly those unemployed for longer durations are likely to find a job. Therefore limiting the duration of short-term unemployment is vital in preventing high and persistent unemployment (ibid).

It is worrying that the number of people claiming JSA for six months or less has been rising for six consecutive months. Until recently, the ILO measure of unemployment had been showing small decreases (ONS 2011a). The claimant count, which is more up-to-date than the ILO measure, could be acting as an early warning signal of future labour market performance, in this case registering the impact of upcoming job losses in the public sector. It could also reflect the high rate of ‘churn’ between jobs at the low-skilled end of the labour market, which tends to be higher in depressed labour markets (Sunley et al 2005). However, Elsby and Smith have argued that low outflow rates from short-term unemployment rather than from long-term unemployment should currently be the prime concern for the UK (Elsby and Smith 2011). We look at different options to improve performance.

### Retraining

Continued shifts in the industrial composition of the UK workforce mean retraining and active labour market policies to help unemployed people find work in new sectors will be crucial to prevent higher unemployment. The UK spends just 0.02 per cent of GDP on employment-related training as part of its welfare-to-work provision, compared to the OECD average of 0.14 per cent (OECD 2010b). The UK has traditionally spent less on active labour market programmes than the OECD average (0.32 per cent compared to 0.57 per cent in 2007/08)<sup>44</sup> and spending is heavily weighted towards job search

<sup>44</sup> This not necessarily because the UK labour market performs better than other OECD countries – the UK has persistently had a large population of working-age inactive adults and very low rates of participation in active labour market programmes (ALMPs) among this group; whereas active measures are much more prevalent for this group in a number of OECD countries.

(accounting for 88 per cent of active measures compared to 26 per cent across OECD countries).<sup>45</sup>

There is strong evidence that a ‘work first’ approach focusing on job search rather than extensive pre-employment training is effective for most jobseekers. Meager (2008) looked at international evidence relating to the role and effectiveness of training and skills interventions as part of a broader range of active labour market policies. He concluded that the evidence was generally not supportive of spending more on retraining, except in the case of ‘smaller-scale measures, targeted on particular groups (such as older workers) or on particular skills and occupations’ (ibid: 22). However, he also highlighted an interesting paradox. Most of the evidence that training has a limited impact comes from micro-level studies of individual programmes. A study by Boone and van Ours (2004) found that job training was the most effective intervention at the macro level when it came to reducing unemployment. This may be because it improves matching between workers and jobs and so reduces flows into unemployment.

There may therefore be scope for more training programmes to support rapid re-entry to employment. One way of targeting retraining is through redundancy schemes, and the Welsh experience is particularly instructive here. Wales has historically had higher than average rates of redundancies due to major restructuring programmes within the manufacturing sector and was therefore able to build on longstanding schemes to respond to the recent recession.

The ReACT scheme has played a key role in addressing the needs of people who have been made redundant, or are facing redundancy, by helping them to gain new skills to find work. It provides a discretionary training award for the individual as well as a recruitment subsidy and a training subsidy for employers to cover the costs of training for employees. A new scheme, ProACT, was set up during the recession to stave off redundancies and encourage employers to retrain staff for the recovery through a similar programme of employer training subsidies. Given Wales’s reliance on the public sector, the Welsh Assembly government is also establishing a sister scheme to respond to public sector job losses. Adapt will provide the same support to private sector employees received through ReACT to help redundant public sector workers gain new skills to find employment.<sup>46</sup>

Though no evaluation has been published of the impact of ReACT during the recession, previous evaluations have shown ReACT beneficiaries to be more likely to be in employment (compared to a control group), more likely to have taken part in training and to have the kind of job they wanted. Outcomes on job sustainability have also been positive<sup>47</sup> (CRG Research 2005). An evaluation of the ProACT scheme shows that it safeguarded 10,635 jobs in 250 firms at a cost of £27 million.<sup>48</sup> Forthcoming evidence is also expected to show that it helped to promote a culture of training and investment in staff among employers who participated in the scheme.

The risk of deadweight costs in these schemes is fairly high, given their relatively untargeted nature. However, there are substantial benefits to helping individuals find new work quickly and retaining them in the labour market (CRG Research 2005). Such schemes could also help tackle problems such as the risk of occupational downgrading associated with redundancy and consequent loss of productivity for the economy as a whole, as well as the particular skills mismatches that are likely to result from the government’s policy of cutting the public sector workforce. Though the redundancy rate has been falling since the height of the recession in 2008/09 it is expected to increase with impending public sector job losses. The government has convened a cross-

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45 Other developed countries tend to spend more on training, employment incentives, supported employment and direct job creation.

46 See Welsh Assembly Government website press release. <http://wales.gov.uk/newsroom/businessandconomy/2011/110208adapt/?lang=en>

47 Beneficiaries were more likely to remain in the same job for six months, with many seeing improvements to their job role over the six months and more likely to have seen an increase in their take-home pay (CDG Research 2005).

48 See Welsh Assembly Government website press release. <http://wales.gov.uk/newsroom/educationandskills/2010/100513proactmil/?lang=en>

government group to examine the potential impact of public sector job losses, but there are no plans for this kind of active support to help those who are affected by it.

**Recommendation:** The government should introduce a UK-wide scheme, along the lines of the Welsh ReACT scheme, to encourage people who are made redundant to retrain for work in other sectors and to encourage employers to recruit and train them. This scheme should last throughout the period of large-scale job cuts in the public sector, when redundancies in the whole economy are likely to be abnormally high, but should be available to workers formerly employed in the public and private sectors.

### Improving job matching

Better job matching will be crucial to improving the job finding rates of the newly unemployed. One way to achieve this would be through better matching of existing skills to jobs. Another would be through improved labour market information – detailed intelligence on existing and future skills needs based on local labour market trends – that will point people in the right direction for their personal development. A regular complaint among jobseekers is a lack of accurate and up-to-date local labour market information and sector-specific job advice (Adams and Carter 2008).

The EU's expert group on skills has highlighted how better labour market information can improve the efficiency of placing people in jobs and can support a more balanced labour market (EU 2010). The better informed individuals are about the local labour market, the more effective their decisions will be, and the more likely they will be to acquire the skill sets required by employers. In its 'New Skills, New Jobs' strategy, the EU called on member states to make labour market information more widely available and to improve the quality and speed of data collection. This would help arm jobseekers with the information they need to make decisions for themselves about which skills to develop or which job opportunities to pursue, based on the best local intelligence.

Although improvements have been made in recent years, there has been a history of problems with the collection of labour market information in the UK and the way it is used by labour market institutions such as sector skills councils (UKCES 2009). Furthermore, while the quality of information collected has improved, there has not been a parallel change to the way that it is made available, particularly to jobseekers. Access to such information through Jobcentre Plus is currently haphazard and not available in easily accessible formats.

In the same way that the government has opened up information and statistics on crime, the health service and public transport, labour market information should be made more freely available to empower people to make better employment and skills choices. Jobcentre Plus is currently transforming the way it works to make digital communication its central means of communicating with customers. This is one platform that could be used to open up labour market information.

However, better labour market information would not just benefit those who are out of work, it could also help people who are unhappy in their current job or are employed in a role that does not fully utilise their skills. It should therefore be made available in other ways, such as through social media or mainstream government websites such as Directgov.

**Recommendation:** The government should make the provision of better local labour market information a priority. Initially, the focus should be on Jobcentre Plus, which, as part of its role, should provide job seekers with information about current and possible future trends in employment demand in their locality and surrounding areas. Eventually, this information should be made more widely available through government websites.

### Tackling long-term unemployment

Higher long-term unemployment risks eroding human capital and increasing discouragement and labour market withdrawal. This risk is greatest for young people and for less skilled workers who have been disproportionately affected by the latest rise in unemployment.



It is well known that a period of long-term unemployment can have a ‘scarring’ effect on the future employment and earnings prospects, particularly of young people (Gregg 2001, Balls 2011). This is bad for the individual and it results in a loss of productivity for the economy as a whole. There is therefore a strong economic and social rationale for intervention to prevent these effects. The key concern for policymakers should be to improve the employment and earnings prospects of groups who face the greatest structural barriers in the labour market.

The government’s main policy response to long-term unemployment is the Work Programme. There are several ways in which the Work Programme as delivered by the prime providers could go further to increase the impact of the support they provide and the likelihood of placing the hardest to help in sustainable employment.

### **Routes to apprenticeships**

The Work Programme will only support a limited number of unemployed young people because only around one half are eligible for Jobseeker’s Allowance at any one time. However, drawing apprenticeships into the Work Programme could strengthen routes into apprenticeships for long-term unemployed young people.

Progression routes from lower to higher level apprenticeships are weak and the government is examining ways to improve the options available for young people furthest from the labour market. One option would be for Work Programme providers to help provide these pathways for young people experiencing long-term unemployment and in so doing improve the relatively low level of employer uptake for apprenticeships.

Many Work Programme providers are already looking to establish stronger relationships with employers by offering a package of support, for example on skills and progression in work as well as hiring and recruitment. Apprenticeships could be another element used to strengthen the employer offer. For Work Programme providers this would also offer access to sustainable entry level placements in the labour market for young people.

There are a number of reasons for the lack of employer uptake of apprenticeships. These include a lack of understanding about the process of getting involved – who to approach and which public sector bodies are responsible – and frequently a lack of awareness about the benefits apprenticeships can bring to businesses (FSB 2010). Building on their relationships with employers, Work Programme providers are in a position to inform businesses about the value of apprenticeships and to support human resources and management functions to allow them to engage.

Valuable lessons have been learned from the Future Jobs Fund (FJF) on how short-term posts can provide pre-apprenticeship training. Groundwork UK in partnership with British Gas trialled using FJF posts as a pre-apprenticeship period (for example in teams of loft insulation or cavity wall technicians). Where young people completed the FJF post, there were opportunities for them to undertake a full apprenticeship with British Gas. Groundwork UK has argued that the Work Programme might consider how FJF-style posts could help young unemployed people gain apprenticeships. The Work and Pensions select committee has also recommended that lessons be learned from the FJF on how to prepare young people furthest from the labour market for apprenticeships (Work and Pensions Select Committee 2010).

The longer length of time individuals will spend on the Work Programme opens up opportunities for sustained pre-apprenticeship training. In place of FJF posts, work trials could offer experience of the workplace in combination with wider forms of support such as employability, basic literacy and numeracy.

The Work Programme could play a valuable role in strengthening routes into apprenticeships and in driving employer uptake. A recent report produced for Working Links, a Work Programme provider, suggested the government should pilot a payment by results scheme for apprenticeships within the Work Programme to help those furthest from the labour market (2011). At present, there is a lack of clarity about the extent to which apprenticeships can be counted as a job outcome by providers under the Work

Programme. Official guidance states that apprenticeships meet the criteria for employment and therefore count as a job outcome. However, a degree of ambiguity remains, which means that some providers are not confident about being able to claim a job outcome for an apprenticeship. This is not least because of the risk of ‘double counting’ of outcomes. As one provider noted: ‘If we claim a job outcome payment from DWP at the same time as a learning provider draws down funding for the apprenticeship, then the government has in effect paid twice for the same outcome.’

There are also concerns about the variable quality of apprenticeships (see Lawton and Norris 2009). Given that the Work Programme could be a valuable route for young people and adults into apprenticeships (many of which require qualifications at college or even university level) it could also ensure better safeguarding of standards for apprenticeships.

**Recommendation:** To strengthen routes into apprenticeships for long term unemployed young people aged over 18 and to improve uptake among employers, clearer guidance should be given to Work Programme providers on the role they can play and any barriers to their participation should be removed.

### **Transitional employment: intermediate labour markets and job guarantees**

Transitional employment programmes (TEPs) are targeted at the long-term unemployed and others who are considered to be some distance from the labour market. Such schemes combine periods of paid work experience with support for job search, career progression and help with barriers to employment like ill-health (Bivand et al 2006). The additional support is vital for the long-term success of TEPs – the goal of such programmes should not simply be to occupy jobseekers for the life of the programme but to support sustainable job outcomes through useful work experience combined with intensive job search support so that participants are able to find work on the open market once the TEP intervention has finished. Therefore jobs created under TEPs should allow for regular job search activities (that is to say, they should not be full-time), and both jobseekers and providers need sufficient incentives to make job search a priority during the phase of transitional employment. Transitional employment pays at least the minimum wage, and is therefore distinct from ‘workfare’ or ‘work for your benefit’ schemes; and from training schemes where participants receive a training allowance.

TEP is a generic term that covers large-scale central government-led job creation programmes as well as locally-based intermediate labour markets (ILMs). ILMs were first designed by local organisations in the 1980s as part of local regeneration projects, with the aim of providing useful work experience for participants as well as productive outputs for the local community. Government-funded TEPs are essentially a variant of marginal hiring subsidies, where the wage costs are subsidised rather than the non-wage labour costs. They are therefore worth consideration as a route to boosting job creation in the early phases of recovery.

A number of studies have identified positive employment outcomes associated with TEPs. Finn and Simmonds (2003) found that transitional employment programmes appear to have positive job outcomes compared to government-led welfare-to-work programmes. The projects they surveyed were on average more expensive than other welfare-to-work provision, but this is to be expected given that TEPs are designed to support those with the greatest labour market disadvantage. Programmes were found to be most successful when they were targeted at those with the highest levels of labour market disadvantage, devised and controlled locally, and included significant support for participants (Finn and Simmonds 2003). Evidence from the US found that poorly targeted and implemented programmes have little impact on employment rates.

StepUP was a substantial TEP that operated in the UK between 2002 and 2004. It provided a guaranteed job and support for up to 50 weeks for people who remained unemployed six months after completing the New Deal, and ran in 20 pilot areas. Employers in the private, public and third sector were paid a subsidy to cover the minimum wage for the work done and a fee to cover additional costs. Participants

received support from a Jobcentre Plus adviser, a local programme manager and a 'workplace buddy'.

The evaluation of StepUP found a statistically significant improvement in job entry for people aged 25 to 49, although the impact was slightly negative for young people (aged 18–24). The programme also had a large positive impact on job entry for people whose initial level of employability was low, but a negative impact for people closest to the labour market. However, most participants had very low levels of employability. The study also found that insufficient time and resources were allocated to job search, particularly in the earlier stages of StepUP jobs.

The Future Jobs Fund, introduced in 2008 by the Labour government, was the largest example of a state-led TEP, designed as a short-term response to the increase in youth unemployment generated by the recession. The use of a locally-driven, demand-led bidding system, rather than central government contracting, meant that the jobs created could be expected to have real social value in local communities (Gregg and Cooke 2010). However, there were concerns about the strength of incentives for providers to help participants back into employment on the open market. The Work and Pensions select committee has highlighted the fact that the programme was cancelled before sufficient information was available to make a proper judgement about its cost-effectiveness (Work and Pensions Select Committee 2010). It is therefore not possible to draw any conclusions about the effectiveness of the FJF, although the select committee recommended that a full evaluation be undertaken.

TEPs that include a guaranteed job like StepUP and the FJF have an additional advantage in that they embed reciprocity in the welfare state, matching the rights and obligations of individuals and the state, and making strict job search requirements credible whatever the state of the labour market. The individual must actively seek work; the state must provide a useful and paid job if none is to be found on the open market; the individual must accept that offer or find an alternative. This approach has the added benefit that, in practice, the element of compulsion 'shakes out' the minority of claimants who have recourse to other means (Gregg and Cooke 2010).

TEPs tend to be associated with higher costs, due to the level of support required by participants and the need to cover wage costs. However, if they are targeted at those furthest from the labour market – primarily the long-term unemployed and young unemployed people with little formal work experience – they may be relatively cost-effective given the relatively low chances of such individuals finding employment through other means (OECD 2010b, Work and Pensions Select Committee 2010). TEPs should therefore be reserved for individuals who have been shown to be unable to find work through supported job search and other standard welfare-to-work interventions.

Furthermore, there are examples of schemes where costs have been in line with standard welfare-to-work programmes. Training Assessment and Progression runs an ILM programme in East Sussex where the cost per client is 25 per cent lower for job ready clients than under the Flexible New Deal, although costs are substantially higher for clients with complex needs (McNeil 2010). The programme has high job outcomes given the multiple barriers faced by most of its client group.

ILMs formed a significant part of the New Deal programmes, and many were partly supported by European funding (Bivand et al 2006). For Work Programme providers, using ILMs and other models of transitional employment as part of the black box approach to employment support will require either outsourcing to established providers or setting up schemes of their own. Employment minister Chris Grayling has said he is 'completely relaxed' about Work Programme prime contractors using a proportion of their fees to subsidise jobs for their Work Programme clients and that it would be for the prime contractors to interpret the EU state aid rules to do so (see Work and Pensions Select Committee 2011). To avoid confusion around EU state aid rules, the Work and Pensions Committee has recommended that the government produce guidance on how intermediate labour markets can be used within the Work Programme.

**Recommendation:** The government should offer a guaranteed job, paid at the minimum wage or above, to anyone who has been unemployed and claiming JSA for more than 12 consecutive months. The guarantee should be matched by an obligation to take up the offer or to find an alternative that does not involve claiming JSA. The job should be for no more than 30 hours a week to allow a reasonable amount of time each week for job search and should last a maximum of six months. Jobs could be provided by the third sector, the private sector or local government. To incentivise a focus on job search, the incentive framework for providers should be heavily weighted towards sustainable job outcomes for participants, following the Work Programme model of at least a portion of payments being made once an individual has been in an ‘open market’ job for a given period of time.

### Increasing the employment rate in the long term

The challenge for the next few years is to ensure that the economy recovers robustly from recession and that the recovery is ‘jobs rich’, so that the employment rate increases from its current level of 70.7 per cent to around 73 per cent – the peak level seen in every economic recovery since 1970.

The longer-term ambition should be to break through the 73 per cent barrier for the employment rate, and eventually to increase it to close to 80 per cent, in line with the highest rates seen across OECD countries. Achieving a higher employment rate will mean increased tax revenues and reduced spending on welfare benefits. Even if all the additional workers earned the minimum wage and one-quarter of them worked part-time, additional revenues from income tax and national insurance alone would be £5 billion a year. More realistically, if the additional workers earned the current median wage, the additional annual revenue would be £20 billion.<sup>49</sup> This will make it easier for the government to maintain a sustainable fiscal position, while continuing to fund first-rate universal services, such as health and education. It will also help society cope with the ageing of the population.

Increasing the employment rate to 80 per cent will require a further significant step-up in the female employment rate in the UK. The current rate, 64.6 per cent, is well below the highest rates in Europe, which are found in Scandinavian countries – Norway (73.3 per cent), Denmark (71.1 per cent) and Sweden (70.3 per cent). This will only happen if there is a significant improvement in childcare provision in the UK.

It is unfortunate therefore that in April the government reduced support to low-income families through the childcare element of the working tax credit from 80 per cent to 70 per cent. This can only act as an increased disincentive to work for parents, particularly mothers. The government’s decision to integrate the childcare element of the tax credit system into the new universal credit could also increase disincentives to work. While the principle of the universal credit is sound, the integration of childcare support into its structure is likely to diminish the affordability of services for many families because of asset means testing and other factors. Reform of the tax credit and welfare systems should involve widening access to free and affordable childcare rather than narrowing it (Ben-Galim 2011).

For parents with young children, childcare costs are a crucial element of the decision whether or not to seek work, and particularly whether or not both parents in couple families work. Families need to make their own choices about how to divide work and care. However, couples with children where only one adult works have substantially higher rates of poverty than those where both parents work (Gottfried and Lawton 2010). Poverty is also much lower among working lone parents than those out of work. It is therefore important that families have the right support in place to facilitate parental employment, including having both parents in work. Unless the government gets its support for childcare right, there is little prospect of the UK employment rate rising above 73 per cent in the long term. Unfortunately, it is currently headed in the wrong direction.

<sup>49</sup> Authors’ calculations, details available on request.

**Recommendation:** The government should reconsider its decisions to reduce the amount of childcare support that can be claimed through the tax credit system and to integrate the childcare element of the tax credit into the universal credit. It should plan to introduce a single, integrated funding system for childcare that merges tax credit provision and the tax relief provided for childcare vouchers. This system should support all parents, but offer the greatest amount of support for those on low incomes.

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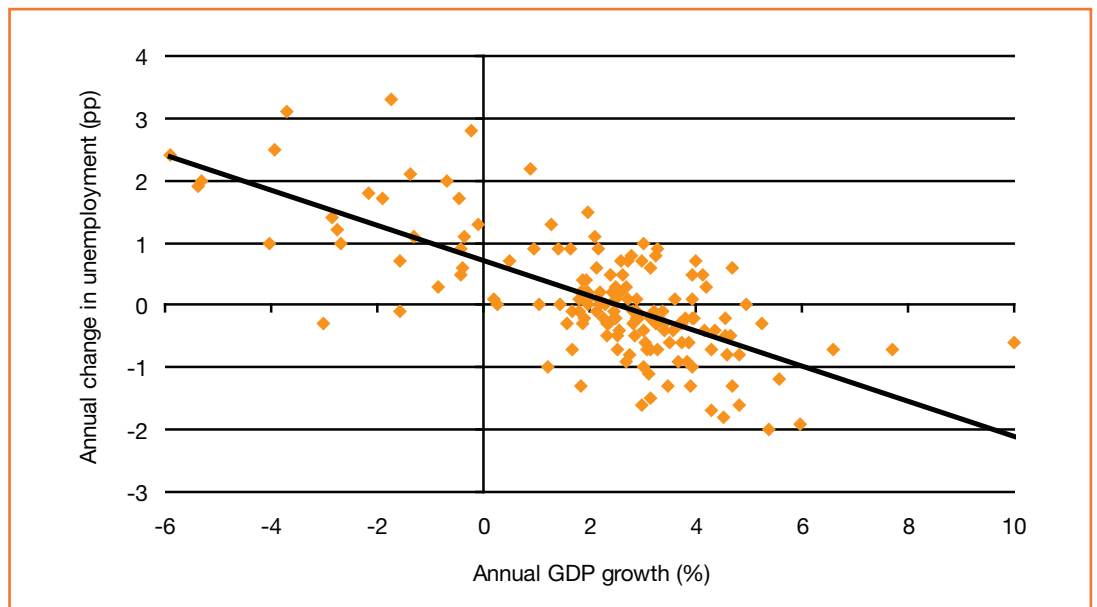
## APPENDIX

### OKUN'S LAW IN THE UK

Okun's law posits a stable relationship between output (real GDP) growth and the change in unemployment in an economy. As such, it assumes that there is a steady rate of productivity (output per person) growth and labour force growth. Only if output growth is fast enough to outstrip both productivity and labour force growth will unemployment fall.

Figure A1 shows this relationship in the UK over the period from 1972 to 2010, plotting quarterly data.

**Figure A1**  
Okun's law – the relationship between real GDP growth and the change in unemployment



Source: ONS, Labour Force Survey and National Accounts

Regression analysis shows that the relationship between unemployment and real GDP growth is a statistically significant one:

$$\Delta U = 0.71 - 0.28 * \Delta Y$$

(9.46)(-12.14)

$$R^2 = 0.49$$

where

$\Delta U$  = change in unemployment over the last four quarters (percentage points)

$\Delta Y$  = change in real GDP over the last four quarters (per cent)

and the figures in brackets are t-statistics

What this means in practice is that, on average, real GDP growth of zero is likely to be associated with a 0.7 percentage point increase in unemployment, while real GDP growth of above 2.5 per cent is needed for the unemployment rate to be falling.



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